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Effect in Montana of Community-Source Property Acquired in Another State (and Its Impact on Montana Marriage, Dissolution, Estate Planning, Property Transfers, and Probate)

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ARTICLES

EFFECT IN MONTANA OF COMMUNITY-SOURCE PROPERTY ACQUIRED IN ANOTHER STATE (AND ITS IMPACT ON A MONTANA MARRIAGE DISSOLUTION, ESTATE PLANNING, PROPERTY TRANSFERS, AND PROBATE)

Charles W. Willey*

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I. INTRODUCTION

When a domiciliary of Montana has an interest in real or personal property that was community property in the domiciliary's former state of residence, that property continues as community property in Montana. This is because: (1) the community property interest is a constitutionally protected, vested interest in the state of original acquisition;¹ and (2) under Montana law it is presumed to continue to be community property at the time of the Montana domiciliary's death, and thus presumptively vested at that time.² Under case law from most other jurisdictions (there is no such case law in Montana), the change of domicile to Montana is not a divesting event. Thus, the property being vested both at the time of original acquisition and at death, it must also be vested during the Montana domiciliary's lifetime. In other words, the move does not change the character of the property.

This doctrine applies not only to property that was community property at acquisition, but to any subsequently acquired property that can be traced back to the original community property. Thus, the doctrine also applies to property acquired from sale proceeds of the original property, property acquired using the "rents, issues, or income" of the original community property, and

1. *Infra* pt. III.B.1.

2. *Infra* pt. IV.B.

property acquired through an exchange of the original community property.³

This concept is critical in Montana even though Montana is otherwise a separate property state.⁴ The doctrine affects the following main areas:

1) *The interests of both spouses in such community-source property upon marriage dissolution in Montana.* California case law holds that a community property interest is a vested property interest that cannot be divested without due process of law.⁵

2) *Montana estate planning and practice.* Under community property law, each spouse has the absolute right to dispose of his or her one-half community property interest by will or by trust, without any joinder by the other spouse.⁶ Hence upon the death of the first spouse, only the decedent's one-half of the community property is subject to federal estate tax.⁷ Further, if the first spouse to die has not executed a will or trust disposing of his or her one-half interest, that decedent's one-half interest passes by intestate succession to the surviving spouse.⁸

3) *New income tax basis in the entire community property upon the first death; second basis adjustment on survivor's death.* Under present federal tax law, community property has a unique tax characteristic not applicable to other property. The death of a spouse terminates the community character of property, and the survivor's interest then becomes her or his separately owned property.⁹ Upon the death of the first spouse to die, the whole property gets a new step-up or step-down in income tax basis, equal to the date-of-death value.¹⁰ If the estate qualifies for an "alternate valuation date" under Internal Revenue Code § 2032 and the personal representative so elects, then the step-up or step-down is to the value of the property on that alternate date.¹¹ When the sur-

3. Mont. Code Ann. § 72-9-102 (2007).

4. *Id.* at § 40-2-202 (speaking in terms of "individual" property).

5. *In re Marriage of Heikes*, 899 P.2d 1349, 1358 (Cal. 1995).

6. Gerald B. Treacy, *Tax Management: Estates, Gifts and Trusts Portfolios: Community Property: General Considerations*, vol. 802-2d, A-18 (Tax Mgt. Inc. 2005).

7. *Id.*

8. Mont. Code Ann. § 72-2-111.

9. Robert L. Mennell & Thomas M. Boykoff, *Community Property in a Nutshell* 5 (2d ed., West 1988); William A. Reppy, Jr. & Cynthia A. Samuel, *Community Property in the United States* 19-1, 19-5 (Lupus Publications, Ltd. 1997); Treacy, *supra* n. 6 at A-9; Cal. Fam. Code Ann. §§ 297.5, 770 (West 2004 & Supp. 2008); Mont. Code Ann. § 40-2-202.

10. Treacy, *supra* n. 6, at A-15 to A-16 (internal citations omitted); 26 U.S.C. § 1014(b)(6) (2000).

11. *Federal Tax Coordinator 2d* vol. 22A, ¶ R-5000 to R-5002 (Thomson 2008).

vivor dies, her or his property qualifies for a second step-up or step-down in income tax basis.¹²

This basis step-up is an extremely valuable benefit for highly appreciated property. The effect of this rule is to avoid, upon a sale by the survivor of her one-half interest, any capital gains tax on any appreciation which has occurred between the date of acquisition of the property and the date of death of the first spouse to die.

Under present law, the step-up in income tax basis of the survivor's half interest occurs so long as the decedent's half interest is includible in the deceased spouse's estate.¹³ This is true "even though an estate tax return for the decedent's estate was not required or, if required, no estate tax was payable."¹⁴

A thirty-nine-year-old Revenue Ruling ruled that a surviving spouse was not entitled to a step-up in basis with respect to property derived from a community property source because it had been reinvested in a non-community state and title there taken as tenants in common. The ruling also determined that for estate tax purposes, the property was still considered community property.¹⁵

A later Ruling indicated that that earlier 1968 result was determined by state law, which did not recognize the property as community property in the second state. In that Ruling, the spouses were residents of a community property state.¹⁶ They used community funds to purchase real property in a non-community state, taking title as joint tenants with right of survivorship. Under the laws of the community property state there involved, the parties had demonstrated their intention to preserve the community character of the property by an express statement in their wills. The Internal Revenue Service stated that, in the earlier Rev. Rul. 68-80,

the controlling factor was the state law determination that the property did not constitute community property. See *Morgan v. Commissioner*, 309 U.S. 78 (1940) (local law creates legal rights and interests; federal law determines the federal tax treatment thereof).

In the present situation, under the laws of X, the property remained community property. Even though the property was held in joint tenancy, a common law estate, the clear intention of D and S,

12. 26 U.S.C. § 1014 (2000); 26 C.F.R. §§ 1.1014-1(a), 1.1014-2(a), 1.1014-4(a)(1) (2007).

13. 26 U.S.C. § 1014(b)(6).

14. 26 C.F.R. § 1.1014-2(a)(5); *Federal Tax Coordinator 2d* vol. 21, ¶ P-4112 (Thomson 2008).

15. Rev. Rul. 68-80, 1968-1 C.B. 348.

16. Rev. Rul. 87-98, 1987-2 C.B. 207.

as expressed in their joint wills, prevented its transmutation to separate property. *Because it is community property under state law, it is also community property within the meaning of section 1014(b)(6).* Therefore, S's interest in one-half of the property receives a [stepped-up] fair market value basis under section 1014(a). . . .

If property held in a common law estate is community property under state law, it is community property for purposes of section 1014(b)(6) of the Code, regardless of the form in which title was taken.¹⁷

This result is consistent with the constitutional cases cited in part V.A. of this article.

The Ninth Circuit agrees with the underlying principle. In *Ricards v. U.S.*,¹⁸ the spouses moved from California to Oregon, where they used California-source community property funds to buy real property, taking title to the Oregon property as tenants by the entirety. Oregon is a common law state.¹⁹ Upon the husband's death, the surviving spouse attempted a "double-dip" for tax purposes. The estate tax return reported only the deceased husband's one-half interest in the property because the other half interest in the property had been purchased with her share of the California community property. The IRS did not contest that. However, the return also claimed a marital deduction for the one-half interest that had been purchased with the deceased husband's share of the California sale proceeds.²⁰ The court stated, "[c]ommunity property is not eligible for the marital deduction under [I.R.C.] § 2056."²¹ Carrying water on both shoulders, the widow claimed that the decedent's one-half interest had been "converted" to separate property by the Oregon property law. The Ninth Circuit gave her argument short shrift, saying:

The district court held that the estate was not entitled to claim the marital deduction under § 2056. The court reasoned that Mr. Ricards' half interest in the Oregon property, even though his separate property under Oregon law, *retained its character as community property* for purposes of § 2056, and was therefore ineligible for the marital deduction. Because we conclude that the court's conclusion was correct, we affirm its judgment.²²

Depending on whether and how Congress acts, this basis step-up rule may not survive after 2009 under the Economic

17. *Id.* (emphasis added).

18. *Ricards v. U.S.*, 683 F.2d 1219 (9th Cir. 1981).

19. *Id.* at 1220.

20. *Id.* at 1220–21.

21. *Id.* at 1222.

22. *Id.* at 1221 (emphasis added).

Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),²³ which prescribes a modified carry-over basis system for decedents who die after 2009.²⁴ EGTRRA's modified carry-over basis rules are very detailed but, in general, provide for a step-up (or step-down) in the basis of property acquired from a decedent dying after December 31, 2009, to the lesser of (1) the decedent's adjusted basis; or (2) the fair market value of the property on the date of the decedent's death.²⁵

The increase in basis is limited to an "aggregate" \$1,300,000 for property transferred to non-spouse persons and \$4,300,000 (\$1,300,000 plus \$3,000,000) for property transferred to a spouse.²⁶ It is believed that absent further Congressional action, this modified carry-over basis regimen will apply for only one year—in effect, to decedents dying in calendar year 2010, because of the EGTRRA "sunset" provisions.²⁷

The "sunset" provisions contained in section 901 of the EGTRRA enactment are not a model of clarity. The Conference Agreement on the "sunset" provision says that the provisions of the Act "do not apply to estates of decedents dying, gifts made, or generation skipping transfers [made] after December 31, 2010."²⁸ The "sunset" provisions make no specific reference to what happens after "sunset" to the income tax rules on basis for property acquired from a decedent. It is the author's understanding that the modified carry-over basis rules contained in I.R.C. § 1022 were an eleventh-hour addition to EGTRRA, which seemingly explains the ambiguity in the "sunset" provision. However, the estate tax provisions of EGTRRA are repealed with respect to decedents dying after the end of 2010, and if Congress does not act before then, the law as it previously existed in 2001 (before enactment of EGTRRA) is resuscitated. Thus if Congress does not act, the Applicable Exclusion Amount for estate taxes would revert to \$1,000,000 after 2010. It therefore seems logical that the full step-up (or step-down) in basis would also be restored at the end of 2010. This interpretation is consistent with the general statement in the

23. 26 U.S.C. § 1022 (2001).

24. Treacy, *supra* n. 6, at A-15.

25. 26 U.S.C. § 1022(a)(2)(A), (B) (2000).

26. *Id.* at §§ 1022(b)(2)(B), 1022(c)(2)(B).

27. J. Martin Burke, Michael K. Friel & Elaine Hightower Gagliardi, *Modern Estate Planning* vol. 2, §§ 28.23, 35.02(1) (2d ed., LexisNexis 2007); *Federal Tax Coordinator 2d* vol. 21, ¶ P-4060 (Thomson 2008).

28. Pub. L. No. 107-84, 115 Stat. 252 (2001).

“sunset” clause that the Act “shall not apply . . . to . . . years beginning after December 31, 2010.”²⁹

It seems likely that Congress will make some sort of change in that law before the end of 2009, since EGTRRA also includes a temporary repeal (in 2010) of the estate tax,³⁰ but one can only speculate as to what the change will be. Some commentators believe that Congress will wait until the eleventh hour to make a change, so its members can continue to receive financial contributions from both supporters and opponents of any particular proposed change.³¹

It has also been widely speculated that the Applicable Exclusion Amount for estate tax purposes (below which no federal estate tax return is required to be filed) will be set in the range of \$3,000,000 to \$5,000,000.³² However, in light of the present budgetary shortfalls and the mammoth cost of the Iraq war, it seems unlikely that an Exclusion Amount in the upper part of that range will be enacted.

The Congressional Research Service’s recent projection of estate and gift tax revenues anticipated that the number of federal estate tax returns filed for 2007 will drop because of the increase in the Applicable Exclusion Amount for 2006–2008 to \$2,000,000.³³ However, the same projection noted that the stability of revenues that have been received, despite previous dramatic drops in the number of taxable estates, is attributable to the increase in taxes collected from the highest-income class, those with gross estates of \$20,000,000 or more.³⁴

As of April 1, 2008, there were no bills pending in Congress that would affect the Applicable Exclusion Amount. However, three bills pending in Congress as of November 2007, none of which has been enacted, proposed setting the Applicable Exclusion Amount in the \$3,000,000 to \$3,500,000 range.³⁵ In response to a query by U.S. Senator Jon Kyl of Arizona, Montana’s U.S.

29. Pub. L. No. 107-16, 115 Stat. 38.

30. Burke, Friel & Gagliardi, *supra* n. 27, at § 28.23.

31. Roy M. Adams, Teleconference, *Recent Developments in Estate Planning* (Missoula, Mont., Mar. 11, 2008).

32. *Id.*

33. Nonna A. Noto, *Estate and Gift Taxes: Past and Projected in 2008* 10 (Cong. Res. Svc. Rpts. Mar. 19, 2008).

34. *Id.*

35. H.R. 4042, 110th Cong. § 2(c) (Nov. 1, 2007); H.R. 4172, 110th Cong. § 2(a) (Nov. 14, 2007); H.R. 4242, 110th Cong. § 3(a) (Nov. 15, 2007); H.R. 4235, 110th Cong. § 4(a) (Nov. 15, 2007).

Senator Max Baucus stated that the Senate Finance Committee, of which he is Chair, would hold a hearing on the estate tax issue in 2007, with the goal of considering legislation in the early part of 2008.³⁶

4) *Transfers of Montana property (real or personal) that had its source in a community property jurisdiction.* The character of the property as community property does not change for federal tax purposes, in the absence of a contrary agreement, merely because the spouses move to a common law (non-community) state.

Community property law governs the interests of a husband and wife in property acquired during marriage in a community property state. A knowledge of community property law is important even in common law property states, because community property retains its community character regardless of removal to a common law property jurisdiction.³⁷ Even when community property is exchanged for other property in a common law property state, the respective interests of husband and wife are protected.³⁸ State community property law governs the rights of spouses in property for purposes of federal income, gift, and estate taxes.³⁹

The doctrine that preserves the community property character of assets transferred to and retitled in a common law state also affects transfers of Montana property (both real and personal) that had its source in a community property jurisdiction. If the spouses move from a community property state to Montana, the benefits of community property may be most clearly preserved by having the spouses enter into a "Community Property Agreement." Such agreements are frequently done in California.⁴⁰ By such an agreement, the spouses can properly reflect their intention that property held in some other form of title, outside of the community property state, is still to remain community property.

36. Office of U.S. Senator Jon Kyl, Press Release, *Senate Finance Committee Chairman Commits to Moving Death Tax Relief Legislation Forward* (Cong. News Releases Oct. 4, 2007) (available at <http://kyl.senate.gov/record.cfm?id=285096>).

37. Treacy, *supra* n. 6, at A-3 (citing *Doss v. Campbell*, 19 Ala. 590, 590 (1851); *Rozan v. Rozan*, 317 P.2d 11, 17 (Cal. 1957); *Restatement (Second) of Conflict of Laws* § 260 (1971)); see also *infra* pt. V (concerning the effect of a spouse moving to a non-community property state like Montana).

38. Treacy, *supra* n. 6, at A-3 (citing *Rozan*, 317 P.2d at 17).

39. *Id.* at A-3 (citing *Poe v. Seaborn*, 282 U.S. 101, 116, 118 (1930) (applying Washington law); *Massaglia v. Commr.*, 286 F.2d 258, 260 (10th Cir. 1961) (applying New Mexico law); *Bishop v. Commr.*, 152 F.2d 389, 391 (9th Cir. 1945) (applying California law)).

40. Reppy & Samuel, *supra* n. 9, at 3-1; Cal. Fam. Code Ann. § 1500 et seq. and § 1600 et seq. (West 2004 & Supp. 2008); Cal. Civ. Code Ann. § 4800(a) (West 1983 & Supp. 1984); 11 Witkin, *Summary of California Law* §§ 24 et. seq. (10th ed., Witkin Leg. Inst. 2005) and supplement § 168B (9th ed. 1990).

The property is still community property without such an agreement. The agreement simply obviates tracing and proof issues.

5) *Montana probate practice*. If property is community property, upon the death of the first spouse to die, only his one-half interest is subject to probate.⁴¹ The surviving spouse's one-half interest is subject to probate upon her death, if she has not given it away before her death.⁴² If the parties have put their entire respective interests into a trust that is funded during lifetime, then neither half interest need be probated.⁴³

6) *Malpractice*. One pair of commentators on community property law have suggested that a lawyer working in a common law state who fails to recognize and preserve his or her client's community property may run afoul of applicable professional conduct rules (and thus be subject to discipline) and may also be committing malpractice.⁴⁴

This article uses California law for the characteristics of community property, because its law provided the prototype for all community property states other than Texas and Louisiana. There are, however, material differences in the details of community property in the various states that have adopted the system, so a Montana practitioner who is dealing with a community property interest must consult the law of the state in which the community property was originally acquired. The Montana Uniform Act that creates the presumption of continuing community property interests refers only to "community property" generically and makes no attempt to determine which state's community property law applies,⁴⁵ so the lawyer must do that.

II. ORIGINS OF THE COMMUNITY PROPERTY SYSTEM AND STATES IN WHICH IT NOW EXISTS

A. *Origins*

The community property system was brought to Spain by the Visigoths. The Visigoths, along with their counterpart, the Os-

41. Treacy, *supra* n. 6, at A-18; Cal. Prob. Code Ann. § 100(a) (West 2002 & Supp. 2008); Mont. Code Ann. § 72-9-107 (2007).

42. Treacy, *supra* n. 6, at A-18.

43. *Drafting California Revocable Trusts* vol. 1, § 1.7, 7 (Marc M. Stern ed., 4th ed., CEB Oct. 2007); John R. Cohan & Geraldine S. Hemmerling, *Inter Vivos Trusts* § 2.12, 88 (Shepard's Citations, Inc. 1975); Cal. Prob. Code §§ 100, 104 (West 2002 & Supp. 2008); Cal. Prob. Code § 5000 (West 1991 & Supp. 2008).

44. Mennell & Boykoff, *supra* n. 9, at 406 (emphasis added).

45. *Infra* pt. IV.

trogoths, made up the Goths, a large East Germanic tribe. These tribes were part of a force that brought down the Western Roman Empire.⁴⁶ After this victory, the Visigoths added their influence to early western European history. The community property system first appeared in written form in a Code (the *Fuero Juzgo*) enacted by the Visigoth society in 693 A.D.,⁴⁷ more than two centuries before the Magna Carta, when the common law first began to coalesce.⁴⁸ This system now exists in Spain, Portugal, and France.⁴⁹ Spain brought the system to the New World and colonized all of Latin America, except Brazil.⁵⁰ Brazil was originally a Portuguese colony, and Portuguese law brought the system there.⁵¹ At present, Cuba and all of the major countries of Latin America, excluding Honduras, utilize the community property system.⁵² The Scandinavian countries also have a form of community property, but it does not exactly coincide with the Spanish model. One commentator states:

At the present day, in Denmark and Norway, a community of goods obtains unless the parties by agreement or contract otherwise stipulate. In Sweden, however, the tendency seems to give each spouse independent control of the property of that spouse owned at the time of marriage or acquired thereafter but with a special legal right in the property of the other which permits of a half share therein upon termination or dissolution of the marriage.⁵³

However, the historic European model of community property differed in one major respect from present American community property law, in that the older European law typically gave sole management rights to the husband. As one pair of commentators stated:

However enlightened the community property system may have been historically in contrast to the feudal system of coverture, in modern times, until the reform of male-management rules, the community property system perpetuated the idea of male-dominance in

46. William Q. de Funiak & Michael J. Vaughn, *Principles of Community Property* 17–18 (U. of Ariz. Press 1971).

47. Mennell & Boykoff, *supra* n. 9, at 11.

48. de Funiak & Vaughn, *supra* n. 46, at 3–4.

49. *Id.* at 20.

50. Reppy & Samuel, *supra* n. 9, at 1–3 (quoting Michael J. Vaughn, *The Policy of Community Property and Inter-Spousal Transactions*, 19 Baylor L. Rev. 20, 35 (1967)).

51. 15 *The New Encyclopædia Britannica* 201–02 (Encyclopædia Britannica, Inc. 2007)

52. Martindale-Hubbell International Law Digest (LexisNexis 2006). Argentina, Bolivia, Brazil and Chile speak in terms of “marriage partnership.” El Salvador and Mexico have an optional community property system, and Paraguay and Uruguay have an “opt-out” community property system. *See also Quintana v. Quintana*, 195 So. 2d 577, 578 (Fla. 3d Dist. App. 1967) (regarding community property in Cuba).

53. de Funiak & Vaughn, *supra* n. 46, at 35.

the marriage more than the common law, which at least gave [the Wife] the right to control her own earnings That male-management [system] has vanished from American community property systems.⁵⁴

B. Adoption of the Community Property System by the American States

All of the states that border Mexico (Texas, New Mexico, Arizona, and California) are community property states.⁵⁵ So is Louisiana, which adopted the system from the then-Code Napoleon when it was a French colony.⁵⁶

Texas is the oldest western community property state.⁵⁷ Its system was originally adopted in California, from whence it spread to all of the other present community property states.⁵⁸ However, Texas subsequently adopted a constitutional provision that now governs community property in that state.⁵⁹ Nevada, Idaho, and Washington also adopted the community property system, based primarily on the California example, many years ago.⁶⁰

In 1984, Wisconsin adopted the community property system when it adopted the Uniform Marital Property Act.⁶¹ Wisconsin uses the terms “marital property” and “individual property” instead of “community property” and “separate property.” However, the difference is one of labels, not of substance.⁶² The Wisconsin Act itself declares that marital property is a form of community property.⁶³

Alaska adopted a Community Property Act effective May 23, 1998.⁶⁴ However, the Alaska system is elective, rather than mandatory as it is in all of the other states.⁶⁵ Puerto Rico, which

54. Reppy & Samuel, *supra* n. 9, at 1-8.

55. *Id.* at 1-1 (quoting Vaughn, *supra* n. 50, at 20).

56. *Id.*

57. *Id.*

58. *Id.* (citing Vaughn, *supra* n. 50, at 21).

59. *Id.* (citing Vaughn, *supra* n. 50, at 20).

60. Reppy & Samuel, *supra* n. 9, at 1-1 (citing Vaughn, *supra* n. 50, at 21).

61. *Id.* at 1-9 to 1-10.

62. *Id.* at 1-10.

63. Wis. Stat. § 766.001(2) (2005–2006).

64. Treacy, *supra* n. 6, at A-11; Alaska Stat. ch. 34.77 (Lexis 2008).

65. Alaska Stat. § 34.77.030 (the Alaska Community Property Act, providing that except as otherwise provided in that Act, “property of spouses is community property . . . only to the extent provided in a community property agreement or a community property trust”).

occupies the unique status of a “commonwealth” of the U.S., also follows community property law, pursuant to its Civil Codes.⁶⁶

Since California’s community property system provided the prototype for all of the other community property laws in the U.S. except Texas and Louisiana,⁶⁷ the examples given herein will be based on California law. One must remember, however, that while it is persuasive, California law does not govern community property in the other states which now have the system.

Prior to 1939, spouses in a community property state equally owned the earnings of one spouse, so each could file a separate income tax return.⁶⁸ This resulted in lower tax brackets because spouses could divide their earnings equally. However, in a separate property state, the earning spouse (typically the husband) had to report all of the earnings on his own return, resulting in those earnings being taxed in a higher bracket.⁶⁹

In an effort to allow their residents to split income for tax purposes, several states tested the water by temporarily enacting community property laws. These states included Oklahoma, Oregon, Hawaii (then a territory), Michigan, Nebraska, and Pennsylvania.⁷⁰

However, in 1948, Congress enacted a tax law that removed this advantage to the community property states.⁷¹ It subsequently allowed a husband and wife to file separate income tax returns (“married, filing separately”), irrespective of whether they lived in a community property state or not.⁷² Following these enactments, the community property laws were repealed in Hawaii, Michigan, Oklahoma, Oregon, and Nebraska.⁷³ The Pennsylvania Supreme Court had already struck down its community property law as unconstitutional.⁷⁴ Currently, the states shaded on the

66. de Funiak & Vaughn, *supra* n. 46, at 88–89.

67. Reppy & Samuel, *supra* n. 9, at 1-1 (quoting Vaughn, *supra* n. 50, at 20). In earlier years, the California statutes on community property were mainly in the Civil Code. Those statutes have now been transferred to the Family Code and have been renumbered.

68. *Commn. of Internal Rev. v. Harmon*, 139 F.2d 211, 216 (10th Cir. 1943); de Funiak & Vaughn, *supra* n. 46, at 89 (internal citations omitted).

69. de Funiak & Vaughn, *supra* n. 46, at 89–90.

70. *Id.* at 89 (internal citations omitted).

71. *Id.* at 91.

72. *Id.*

73. *Id.*

74. *Id.*

Under the community property system, each of the spouses has an interest in the community property.⁷⁸ That interest is (1) presently existing; (2) equal; (3) undivided; (4) considered vested at the time of original acquisition; and (5) generally subject to joint management.⁷⁹ In 1927, California briefly synopsisized this concept with legislation that expressly provided that the respective interests of husband and wife in the community during the marriage are “present, existing and equal interests.”⁸⁰

“The principle which lies at the foundation of the whole community property system is that whatever is acquired by the joint efforts of the husband and wife shall be their common [community] property.”⁸¹ The legal theory is that the marriage, “in respect to property *acquired* during its existence, is a community of which each spouse is a member.”⁸² Because each spouse equally contributes to its prosperity by his or her industry, each possesses an equal right to succeed to the property after its dissolution, if one spouse survived the other and the deceased spouse did not dispose of his or her one-half share by will or trust.⁸³

The common law system, on the other hand, suspend[ed] the wife’s legal existence during the marriage, or at least consolidate[d] it into that of the husband. It assume[d] that she was incompetent, and that the husband must act in the capacity of a guardian. “During the marriage, she is nothing and has nothing.” Marriage [under the old common law system] is for the women a sort of civil death.⁸⁴

Some commentators have noted “[c]ommunity property . . . is wholly repugnant and inimical to the common law because of its elevation of the wife to a position of equality with the husband Each [spouse] is a distinct, separate person, capable of holding distinct and separate estates.”⁸⁵ In commenting on the adoption in the Western U.S. of the community property system from Spanish law, two leading authors have reflected:

It seems safe to assume that the adoption of the community system in all these western states was simply a reflection of the larger movement toward improvement in the property status of the mar-

78. de Funiak & Vaughn, *supra* n. 46, at 2.

79. Reppy & Samuel, *supra* n. 9, at 1-6.

80. de Funiak & Vaughn, *supra* n. 46, at 309; Cal. Fam. Code § 751 (West 2006).

81. Reppy & Samuel, *supra* n. 9, at 1-2 (quoting Vaughn, *supra* n. 50, at 26 (internal citations omitted)).

82. *Id.* (emphasis added).

83. *Id.*

84. *Id.* at 1-6 (quoting Vaughn, *supra* n. 50, at 48).

85. *Id.* at 1-7 (quoting Vaughn, *supra* n. 50, at 48).

ried women, its particular form being in large measure influenced by California legislation.⁸⁶

B. The Effects of Time and Method of Acquisition

1. Determination of Property's Character

The character of community property is determined at the time of original acquisition.⁸⁷ The basic California statute, which is typical for community property states, provides: "Except as otherwise provided by statute, all property, real or personal, wherever situated, acquired by a married person during the marriage while domiciled in this state is community property."⁸⁸ In *In re Marriage of Haines*,⁸⁹ the California appellate court summarized the applicable doctrines as follows:

Generally, factors determinative of whether property is separate or community are the time of the property's acquisition; operation of various presumptions; particularly those concerning the form of title; and whether the spouses have transmuted or converted the property from separate to community or vice versa.

Perhaps the most basic characterization factor is the time when the property is acquired in relation to the parties' marital status. The status of property as community or separate is normally determined at the time of its acquisition. This is particularly true because of the general presumption that property acquired during marriage by either husband or wife or both while domiciled in California is community property, except as otherwise provided by statute. This rule can be altered by agreement of the spouses. For example, spouses can indicate their intent with respect to the character of the property initially by specifying the form of title in which it is held, or spouses can later transmute the character of the property as between each other.⁹⁰

In *Haines*, the wife had delivered a quitclaim deed of the property in issue to the husband, thus vesting record title in him alone.⁹¹ The appellate court set aside the quitclaim deed and concluded that the realty property involved was still community prop-

86. Reppy & Samuel, *supra* n. 9, at 1-4 (quoting Vaughn, *supra* n. 50, at 36).

87. *In re Marriage of Buol*, 705 P.2d 354, 357 (Cal. 1985); *In re Marriage of Bouquet*, 546 P.2d 1371, 1376 (Cal. 1986) (stating "[t]he status of property as community or separate is normally determined at the time of its acquisition" (internal quotations omitted)); *In re Summers*, 332 F.3d 1240, 1242-43 (9th Cir. 2003) (applying California law) (internal citations omitted).

88. Cal. Fam. Code Ann. § 760 (West 2004 & Supp. 2008).

89. *In re Marriage of Haines*, 39 Cal. Rptr. 2d 673 (Cal. App. 4th Dist. 1995).

90. *Id.* at 682 (internal citations and quotations omitted). See *infra* pt. IV.C.7 regarding the requirements for effecting a transmutation.

91. *Haines*, 39 Cal. Rptr. 2d at 677.

erty.⁹² There is a presumption that the record title correctly reflects the status (community or separate) of the property,⁹³ but the *Haines* court held that the case was governed by the more specific presumption that an advantage had been gained by the husband through the exercise of undue influence in violation of his fiduciary duty to his spouse.⁹⁴ The California Legislature conditioned the power of spouses to transact business with each other on their compliance with the fiduciary standard.⁹⁵

2. *Property Acquired in a Community Property State*

Property acquired by spouses while domiciled in a community property state such as California is presumed to be community property, unless it was owned before marriage or was acquired afterward by gift, inheritance, or by one of the other separate property categories described below. The enormous scope of the California statutory presumption that property acquired by the spouses during marriage is community property is set forth in *Katz v. U.S.*,⁹⁶ in which the Ninth Circuit applied California law. The court stated:

There is a statutory presumption that property acquired by the spouses during marriage is community property. The presumption is a strong one, which the California Supreme Court has characterized as fundamental to the community property system. It can be overcome only by clear and satisfactory proof. It is even stronger when the property was acquired with community property. It extends to every conceivable type of property, including insurance policies and their proceeds; a cause of action for wrongful death or injury to a minor child; . . . a law practice; the interest of a spouse in a partnership; good will of a business; borrowed money; and leasehold interests.⁹⁷

The court there held that the community property character of the assets conveyed to a trust continued to be community property.⁹⁸ That rule is now statutory in California. California Family Code Annotated § 761 now provides in substance that: (1) unless the trust instrument or instrument of transfer expressly provides otherwise, community property that is transferred into a

92. *Id.* at 689.

93. *Id.* at 682.

94. *Id.* at 689.

95. *Id.* at 684–85 n. 10; Cal. Fam. Code Ann. § 721(b) (West 2004 & Supp. 2008).

96. *Katz v. U.S.*, 382 F.2d 723 (9th Cir. 1967).

97. *Id.* at 728 (internal citations omitted).

98. *Id.* at 730.

trust remains community property during the marriage, so long as the trust is revocable during the marriage; and (2) any power to modify may be exercised only with the joinder or consent of both spouses.⁹⁹

Community property includes post-marriage personal earnings. In *In re Marriage of House*,¹⁰⁰ the California Court of Appeals held that a physician's earnings earned during marriage were community property, as were the resulting receivables.¹⁰¹

Finally, property is presumed to be community property if the acquisition instrument describes the parties as husband and wife. If the spouses acquire property under a deed or other written instrument in which they are described as husband and wife, that description raises a presumption that the asset is community property, unless a different intention is specifically stated in the instrument.¹⁰²

IV. THE IMPORTANCE OF COMMUNITY-SOURCE PROPERTY IN MONTANA

A. *Montana Statutes Concerning Spouses' Rights in Non-Community-Source Property*

With respect to property that does *not* have its source in community property acquired in another state, Montana is a common law (i.e., individual, separate property) jurisdiction. For example, Montana Code Annotated § 40-2-201 specifies:

When husband's and wife's interests separate. Neither husband nor wife has any interest in the property of the other, except as mentioned in 40-2-102, but neither can be excluded from the other's dwelling unless enjoined by a court.¹⁰³

Montana Code Annotated § 40-2-202 provides:

All of the property of a married person owned before marriage and that acquired afterward is his or her individual property. The mar-

99. Cal. Fam. Code Ann. § 761(a) (West 2006). Subsection (b) of this statute permits a trust instrument to give the power to revoke to either spouse acting alone. Most California lawyers do not do that because it tends to eviscerate an estate plan if unilateral revocation powers are exercised.

100. *In re Marriage of House*, 123 Cal. Rptr. 451 (Cal. App. 2d Dist. 1975).

101. *Id.* at 452; but see *infra* pt. IV.C.6 (discussing a "real" separation).

102. *In re Marriage of Fabian*, 715 P.2d 253, 256 (Cal. 1986); *Katz*, 382 F.2d at 729 (declaration of trust described the husband as "a married man" and the woman as "the Trustor's wife" or "wife of the Trustor," so trust assets were presumed to be community property); see also *In re Marriage of Orchard*, 273 Cal. Rptr. 499, 503 (Cal. App. 1st Dist. 1990).

103. Mont. Code Ann. § 40-2-102 (2007).

ried person may, without the consent, agreement, and signature of his spouse, convey and transfer his individual property, real or personal, including the fee simple title to real property, or execute a power of attorney for the conveyance and transfer thereof.¹⁰⁴

This parallels separate property under the community property system. Similarly, Montana Code Annotated § 40-2-207 governs the proceeds of a married person's work, providing that:

All work and labor performed by a married person for a person other than his spouse and children shall, unless there is a written agreement on his part to the contrary, be presumed to be performed on his separate account. This section does not affect the liability of earnings for debts incurred for necessary articles procured for the use and benefit of the married person, his spouse, or minor children, as established by 40-2-205, 40-2-206, 40-2-209, and 40-2-210.¹⁰⁵

B. Impact of the Uniform Disposition of Community Property Rights at Death Act

Montana law is different for property that had its source in out-of-state community property. In 1989, Montana adopted the Uniform Disposition of Community Property Rights at Death Act.¹⁰⁶ The Act created a pair of rebuttable presumptions as follows:

(1) property acquired during marriage by a spouse of that marriage while domiciled in a jurisdiction under whose laws property could then be acquired as community property [i.e., in a community property state] is presumed to have been acquired as or to have become and remained [community] property to which this part applies; and

(2) real property situated in this state and personal property, wherever situated, acquired by a married person while domiciled in a jurisdiction under whose laws property could not then be acquired as community property, title to which was taken in a form which created rights of survivorship [i.e., joint tenancy] is presumed not to be [community] property to which this part applies.¹⁰⁷

Although the language of § 72-9-103 is a little dense, its practical effect is that property acquired by spouses while domiciled in a community property state is not only presumed to have been acquired as community property, but also to have remained community property.

104. *Id.* at § 40-2-202.

105. *Id.* at § 40-2-207.

106. *Id.* at §§ 72-9-101 to -120.

107. *Id.* at § 72-9-103.

This Act creates a presumptive vested right, effective upon the death of a married person holding an interest in such community property.

Upon death of a married person, one-half of the [community] property to which this part applies is the property of the surviving spouse and is not subject to testamentary disposition by the decedent or distribution under the Uniform Probate Code. One-half of that [community] property is the property of the decedent and is subject to testamentary disposition or distribution under the Uniform Probate Code. With respect to [community] property to which this part applies, the one-half of the property which is the property of the decedent is not subject to the surviving spouse's right to elect against the will.¹⁰⁸

Thus, the effect of this section is to provide that upon death of one spouse, only the deceased spouse's one-half interest in the presumed community property is subject to probate in Montana, and that one-half is not subject to a widow's election. The other one-half of the presumed community property, which would be the surviving spouse's share, is not subject to probate upon the death of the first spouse to die, and is not subject to federal estate tax.¹⁰⁹

This Act is extremely broad in its scope because under the Montana Code, it applies to the disposition at death of the following property acquired by a married person:

- (1)(a) all personal property, wherever situated, that was acquired as or became and remained community property under the laws of another [community property] jurisdiction;
- (b) all or the proportionate part of that property acquired with the rents, issues or income of, the proceeds from, or in exchange for that community property; or
- (c) property traceable to that community property; or
- (2) all or the proportionate part of any real property situated in this state that was acquired with the rents, issues, or income of, the proceeds from, or in exchange for property acquired as or which became and remained community property under the laws of another [community property] jurisdiction, or property traceable to that community property.¹¹⁰

This section effectively reverses the practical effect of two normal Conflict of Laws rules. First, under the usual Conflict of Laws rules, the character of real property located in the forum state is typically determined by the law of that state.¹¹¹ Montana is a separate property state, but by virtue of this Act, real property

108. *Id.* at § 72-9-107.

109. *U.S. v. Silverman*, 859 F.2d 1352, 1353-54 (9th Cir. 1988).

110. Mont. Code Ann. § 72-9-102.

111. Eugene F. Scoles et al., *Conflict of Laws* § 20.2, 996 (3d ed., West 2000).

that is presumed to be community property under other sections of the Act, because it has its source in community property acquired elsewhere, is deemed community property in Montana under the laws of the source state, upon the death of either co-owner.

Second, under the normal Conflict of Laws rules, upon the death of a person, the situs of moveable personal property is deemed to be the state in which the decedent was domiciled at the time of death, and the law of that situs governs the character of the property.¹¹² However, under this Act, the domicile of the decedent in Montana at the time of death is irrelevant, because even personal property (including that acquired by use of the rents, issues, income from, proceeds from, or exchange of property derived from original community property) still remains community property under Montana law.¹¹³

Volume 8A of the Uniform Laws Annotated contains this Uniform Act. It does not disclose any decisions by any of the enacting states. However, the Prefatory Note to the Act states:

This Act has a very limited scope. If enacted by a common law state, it will only define the dispositive rights, at death, of a married person as to his interests at death in property "subject to the Act," and is limited to real property, located in the enacting state, and personal property of a person domiciled in the enacting state. The purpose of the Act is to preserve the rights of each spouse in property which was community property prior to change of domicile, as well as in property substituted therefor where the spouses have not indicated an intention to sever or alter their "community" rights. It thus follows the typical pattern of community property which permits the deceased spouse to dispose of "his half" of the community property, while confirming the title of the surviving spouse in "her half."¹¹⁴

As noted earlier, the Montana Act relating to community property affects not only family law, but also estate planning, property transfers, probate practice, and federal estate tax returns. The effect of this law is so pervasive that it cannot be safely ignored by a Montana lawyer.

A recent text on Conflict of Laws illustrates the effect of this uniform law in the context of earlier common law, saying:

112. *Id.* at §§ 20.3–4, 999–1002.

113. Mont. Code Ann. § 72-9-102.

114. Uniform Disposition of Community Property Rights at Death Act, 8A U.L.A. 214 (2003).

The leading American case involved a husband who wrongly took funds belonging to the community from Louisiana and invested them in Missouri land, taking title in his own name. The husband was compelled to hold the title in trust to protect the wife's interests. . . . This recognition of the tracing of community property rights into assets held in common law states is confirmed in the Uniform Disposition of Community Property at Death Act. If the land in question is purchased partially with separate property and partially with funds of the community, the question is complicated as a mathematical matter but the principle of tracing does not change, and the proportionate interests of the parties are recognized.¹¹⁵

As discussed further below, one of the key characteristics of the community property system is that each spouse has an *existing vested interest* in the spouses' community property.¹¹⁶ When the spouses are domiciled in a community property state, their rights in their community property become vested when acquired. When they move to Montana, under the Uniform Act quoted above, the property is presumed to continue to be community property and thus vested at the time of death. Hence, the Act's Prefatory Note speaks to the purpose of preserving the rights of each spouse in property that was community property prior to change of domicile, as well as property substituted for it.¹¹⁷

Montana law appears to be silent as to the status of the property between the time that a couple moves from a community property state to Montana and the date of death of the first of the spouses to die. Since, however, each spouse is deemed to have a vested interest at the time the property was acquired, and is presumed to still have a vested interest at the time of his or her death, logically the property must continue to be community property during the interval between the spouses' move to Montana and the first spouse's death. This result seems to also be buttressed by the constitutional and other cases discussed below, and by the Introduction to Tax Management Portfolio 802-2d.¹¹⁸ In a marriage dissolution context, the importance of this vested interest is that upon a dissolution of marriage in Montana, a spouse who had a community property interest may not be divested of

115. Scoles et al., *supra* n. 111, at § 14.6, 586 (discussing *Depas v. Mayo*, 11 Mo. 314, 49 Am. Dec. 88 (1848)) (internal citations omitted).

116. Reppy & Samuel, *supra* n. 9, at 1-6.

117. Uniform Disposition of Community Property Rights at Death Act, 8A U.L.A. 213-14.

118. Treacy, *supra* n. 6, at A-18.

that interest in the dissolution proceeding without due process of law.

The California constitutional cases cited in Part V.A.1 below, which state the rule that a vested property interest cannot be divested without due process, arose in the context of constitutionally impermissible, retroactive state legislation. The California courts did not identify the category of due process to which they were referring, but it was necessarily substantive due process. As two commentators recently observed, “[s]ubstantive due process is addressed to what government can do. Procedural due process inquires into the way government acts and the enforcement mechanisms it uses.”¹¹⁹

Before a federal court addresses a question of procedural due process, the court must first find that a protected substantive right or interest is at stake. As the U.S. Supreme Court stated in *American Manufacturers Mutual Insurance Co. v. Sullivan*:¹²⁰

The first inquiry in every due process challenge is whether the plaintiff has been deprived of a protected interest in “property” or “liberty.” Only after finding the deprivation of a protected interest do we look to see if the State’s procedures comport with due process.¹²¹

In *Logan v. Zimmerman Brush Co.*,¹²² the Court expressed this same concept in a property rights context, saying:

Justice Jackson, writing for the Court in *Mullane v. Central Hanover Bank & Trust Co.*,¹²³ observed: “Many controversies have raged about the cryptic and abstract words of the Due Process Clause but there can be no doubt that at a minimum they require that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case.”¹²⁴ At the outset, then, we are faced with what has become a familiar two-part inquiry: we must determine whether Logan was deprived of a protected interest, and, if so, what process was his due.

The first question, we believe, was affirmatively settled by the *Mullane* case itself, where the Court held that a cause of action is a species of property protected by the Fourteenth Amendment’s Due Process Clause.¹²⁵

119. Jerome A. Barron & C. Thomas Dienes, *Constitutional Law in a Nutshell* 253 (6th ed. 2005).

120. *Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40 (1999).

121. *Id.* at 59 (internal citations omitted).

122. *Logan v. Zimmerman Brush Co.*, 455 U.S. 422 (1982).

123. *Mullane v. C. Hanover Bank & Trust Co.*, 339 U.S. 306 (1950).

124. *Id.* at 313.

125. *Logan*, 455 U.S. at 428.

A protected property interest, such as a community property interest, is derived from state law. In *Cleveland Board of Education v. Loudermill*,¹²⁶ the Court observed that “[p]roperty interests are not created by the Constitution, ‘they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law.’”¹²⁷ This author believes that a community property interest that was acquired in a community property state before the owner moved to Montana qualifies for due process protection under both the U.S. Constitution and state law.

In *Logan*, the U.S. Supreme Court considered a claim of wrongful termination under the Illinois Fair Employment Practices Act.¹²⁸ The plaintiff charged that he had been deprived by a state commission of a protected property interest in violation of the Due Process Clause of the Fourteenth Amendment.¹²⁹ The Court accepted his characterization of his claim as a property interest, saying:

[T]he view that Logan’s FEPA claim is a constitutionally protected one follows logically from the Court’s more recent cases analyzing the nature of a property interest. The hallmark of property, the Court has emphasized, is an individual entitlement grounded in state law, which cannot be removed except “for cause.” Once that characteristic is found, the types of interests protected as “property” are varied and, as often as not, intangible, relating “to the whole domain of social and economic fact.”¹³⁰

Once the determination is made that a community property interest is a substantively protected one, then the requirements of procedural due process must be satisfied. At a minimum, procedural due process requires a procedure that provides “fundamental fairness.”¹³¹

As noted in *Logan*, such due process requires “notice and [an] opportunity for hearing appropriate to the nature of the case.”¹³² This requirement for reasonable notice and an opportunity for a hearing has been applied by the Supreme Court in a marriage dissolution case.¹³³ The notice element in a property case was articu-

126. *Cleveland Bd. of Ed. v. Loudermill*, 470 U.S. 532 (1985).

127. *Id.* at 538 (quoting *Bd. of Regents v. Roth*, 408 U.S. 564, 577 (1972)); see also *Paul v. Davis*, 424 U.S. 693, 709 (1976).

128. *Logan*, 455 U.S. at 424.

129. *Id.* at 426–27.

130. *Id.* at 430 (internal citations omitted).

131. *Lassiter v. Dept. of Soc. Servs.*, 452 U.S. 18, 24–25 (1981).

132. *Logan*, 455 U.S. at 428.

133. *Griffin v. Griffin*, 327 U.S. 220, 229–34 (1946).

lated by the U.S. Supreme Court in *Lambert v. California*¹³⁴ as follows:

Engrained in our concept of Due Process is the requirement of notice. Notice is sometimes essential so that the citizen has the chance to defend charges. Notice is required before property interests are disturbed, before assessments are made, before penalties are assessed. Notice is required in a myriad of situations where a penalty or forfeiture might be suffered for mere failure to act.¹³⁵

California agrees.¹³⁶

If a Montana court handling a marriage dissolution proceeding, a contested probate, or other property entitlement proceeding issued an order purporting to divest a party of a community property interest acquired in another state, the element of a hearing would ordinarily be satisfied. If, however, the order proposed to change or divest the *character* or ownership of that community property interest, procedural due process requires that the party be given reasonable notice. The notice required in a Montana dissolution case is not only that ownership of the property is to be determined or allocated, but also that the community property character of the property will be affected.

In light of this, any Montana attorney handling such a proceeding has an obligation to determine in advance whether a party has a community property interest in the property subject to the litigation, and to specifically advise both the party and the court that a community property interest is at issue. If the ownership of the asset at issue is adjudicated without reasonable notice that a community property interest is involved, any resulting order, as well as any asset allocation made by a settlement agreement, may well be void, or at least voidable, due to noncompliance with procedural due process.

In many instances, the “equitable apportionment” of property under Montana Code Annotated § 40-4-202 may provide a substantially similar result, even if community property interests are not considered. The hazard, however, is that if notice is not given that community property interests are to be divided, and after the

134. *Lambert v. Cal.*, 355 U.S. 225 (1957).

135. *Id.* at 228.

136. See *Anderson v. Super. Ct.*, 262 Cal. Rptr. 405, 407–09, 412 (Cal. App. 4th Dist. 1989) (lower court ordered custodial mothers who were exempt from work requirements for Aid For Dependent Children, appearing in matters relating to fathers’ child support obligations, to undertake job searches or have their AFDC benefits reduced; appellate court held mothers’ due process rights were violated by lack of adequate and timely notice, before appearance, of procedure under which they might lose benefits).

division the share allocated to one spouse appreciates materially vis-à-vis the share allocated to the other, the spouse who received the less-appreciating share is likely to seek a redetermination. In such circumstances, the lack of due process notice can provide a fertile ground for relitigation and for claims against counsel.

The California cases concerning marriage dissolution allow an unequal division of the community property, so that each individual asset does not have to be split down the middle. However, there must be an equitable division of the property—in effect, an equivalence in value.¹³⁷

At the individual lawyer level, there is a danger that the lawyer will ignore community property aspects of a case. A Montana practitioner who fails to assert and preserve his or her client's community property interests in a Montana marriage dissolution proceeding, or who fails to preserve community property in the client's property transfers or estate planning documents, may be doing so at his or her own peril. "An attorney who does not pursue zealously the client's right to community property may face both professional discipline and malpractice claims."¹³⁸ Community property states differ enough that it will be as necessary to distinguish the state of origin of the community property (e.g., Texas as opposed to California community property) as to distinguish acquisition periods (e.g., "pre-1927" versus "post-1927" California community property¹³⁹) when statutes or other law changes apply only prospectively.

The significance of the year 1927 in California law is that prior to 1927, a wife had only an *expectant* interest. However, in 1927, the Legislature enacted a statute which expressly provided that the respective interests of husband and wife in the community during the marriage are "present, existing and equal interests." Thus, after 1927, a wife in California has a complete and existing one-half share.¹⁴⁰

137. *In re Marriage of Tammen*, 134 Cal. Rptr. 161, 163 (Cal. App. 1st Dist. 1976) (interpreting former Cal. Civil Code Ann. § 4800, now renumbered as Cal. Fam. Code Ann. §§ 2601–28 (West 2004 & Supp. 2008)).

138. Mennell & Boykoff, *supra* n. 9, at 406.

139. de Funiak & Vaughn, *supra* n. 46, at 266.

140. *Id.* at 266–67 (quoting former Cal. Civ. Code Ann. § 5105 (West 1970), now renumbered as Cal. Civ. Code § 751 (West 2004)).

*C. Additional Special Rules and Practices That Govern
California Property (Community and Separate)*

*1. Rebuttable Presumption That Title Reflects True Character
of Property*

In *Haines*, the court noted that there is a general common law presumption in favor of the character of the property being determined by the form of title.¹⁴¹ The court stated, “[t]herefore, absent a contrary statute, and unless ownership interests are otherwise established by sufficient proof, record title is usually determinative of characterization.”¹⁴²

However, a number of cases confirm that the form in which record title is held is not controlling and that the court, upon appropriate proof, may determine the true character of the property to be otherwise.¹⁴³ In other words, record title can be in either spouse, and the property may still be held to be community property.¹⁴⁴

2. Record Title May Be Held in One Spouse’s Name as Business Convenience

In a community property state it is not unusual for title to an asset to be vested in one spouse alone, irrespective of its true character, as a business convenience. If one spouse is a participant with other parties in a business, whether it is a partnership, limited liability company, or corporation, it is not at all unusual for the other owner-members to insist that the title to that interest be held solely in the name of the spouse who is the active participant in the business.

Many business people are very reluctant to have the spouse of a co-owner participating in business decisions of the business if the spouse is not actively involved in the business and therefore not knowledgeable about it. In those circumstances, record title may be vested in the spouse who is the participant in the business (whether it be husband or wife), in an effort to ameliorate this practical problem. This “solution” does not of course solve the

141. *In re Marriage of Haines*, 39 Cal. Rptr. 2d 673, 682 (Cal. App. 4th Dist 1995) (citing Cal. Evid. Code Ann. § 662 (West 1995 & Supp. 2008)).

142. *Id.* at 682. The *Haines* court held that record title in the husband’s name did not control because he had obtained it by a breach of his fiduciary duty to his wife. *Id.* at 683.

143. *Faust v. Faust*, 204 P.2d 906, 908 (Cal. Dist. App. 1949); see also *DeBoer v. DeBoer*, 244 P.2d 953 (Cal. Dist. App. 1952); *In re Kalben’s Est.*, 273 P.2d 693 (Cal. Dist. App. 1954).

144. *Id.*

problem in the event of a marriage dissolution, where the true character of the property may be proved to be community, or in a death situation in which the other business owners may be forced to deal with the deceased owner's personal representative or trustee. Many small businesses endeavor to deal with this problem by having a stock purchase agreement (or its partnership or limited liability company equivalent) under which a deceased member's interest may be bought out by the survivors shortly after death. These arrangements are often funded by life insurance, but counsel needs to consider the tax implications of how the life insurance is owned and who pays for it.

3. Tort Cause of Action Accrued during Marriage is Community Property unless Parties Were Permanently Separated at Accrual

Under California Family Code § 780, damages for personal injury, whether by judgment or settlement, are community property if the cause of action arose during the marriage.¹⁴⁵ However, an exception to that rule provides that such personal injury damages are separate property if the cause of action arose while the parties were living separate and apart.¹⁴⁶

*In re Marriage of Klug*¹⁴⁷ applied the same personal injury rules to a cause of action for legal malpractice.¹⁴⁸ There, the husband had, with the assistance of an unethical attorney, transferred more than one-half million dollars from a community brokerage account to an account under his sole control in the Isle of Man in England.¹⁴⁹ After the separation, the husband continued to transfer large amounts of community property to other offshore accounts, including an account in the Isle of Guernsey, and to an overseas insurance company, all with the assistance of the attorney, but without the consent of the wife.¹⁵⁰

The wife subsequently sued the attorney for malpractice and recovered a settlement of \$346,000.¹⁵¹ In the dissolution case, the

145. Cal. Fam. Code Ann. § 780 (West 2004 & Supp. 2008).

146. *Id.* at § 781. However, as noted *infra* pt. IV.C.6, the separation must be "real" and must not be a temporary arrangement.

147. *In re Marriage of Klug*, 31 Cal. Rptr. 3d 327 (Cal. App. 3d Dist. 2005).

148. *Id.* at 331–34.

149. *Id.* at 330.

150. *Id.*

151. *Id.* at 330–31.

husband claimed half of that settlement.¹⁵² The trial court awarded the entire settlement to the wife on the ground that the cause of action had arisen after the separation.¹⁵³ The appellate court found that the wife's cause of action had matured at separation—in effect, that the duty of the attorney had arisen and it had been breached, but that she had not yet sustained any injury that was “legally cognizable as damages.”¹⁵⁴ Since, however, the off-shore transfers benefited the husband rather than the attorney, the doctrine of unclean hands precluded him from participating in her settlement of the malpractice action.¹⁵⁵ Hence, the \$346,000 was held to be her separate property.¹⁵⁶

4. *Family Law Presumes Jointly-Held Property to Be Community Property but Only in Dissolution or Legal Separation Proceedings*

Property held in joint tenancy, tenancy in common, or tenancy by the entireties form is presumed to be community property, but only in dissolution or legal separation proceedings. This rule, which is certainly contrary to a lawyer's normal intuition, first came into existence in 1965 when the California Legislature enacted former Civil Code § 164.¹⁵⁷ As then enacted, the statute stated:

When a single family residence of a husband and wife is acquired by them during marriage as joint tenants, for the purpose of the division of such property upon dissolution of marriage or legal separation only, the presumption is that such single family residence is the community property of said husband and wife.¹⁵⁸

As noted later in a discussion concerning transfer of community property to a common law (separate property) jurisdiction, the California Supreme Court in *In re Marriage of Buol*¹⁵⁹ held that this statute could not be applied retroactively.¹⁶⁰ The much

152. *Id.* at 331.

153. *Klug*, 31 Cal. Rptr. 3d at 331.

154. *Id.* at 335.

155. *Id.* at 337.

156. *Id.*

157. Cal. Civ. Code Ann. § 164 (1965).

158. *Id.* This statute was later amended so it is no longer limited to the family home. Cal. Civ. Code Ann. § 4800.1 (West 1984), now renumbered as Cal. Fam. Code § 2581 (West 2004 & Supp. 2008).

159. *In re Marriage of Buol*, 705 P.2d 354 (Cal. 1985).

160. *Id.* at 355.

broader present rule is reflected in California Family Code § 2581, which provides:

For the purpose of division of property on dissolution of marriage or legal separation of the parties, property acquired by the parties during the marriage in joint form, including property held in tenancy in common, joint tenancy, or tenancy by the entirety, or as community property, is presumed to be community property.¹⁶¹

This is a rebuttable presumption affecting the burden of proof. It may be rebutted by either: (1) a clear statement in the deed or other document of title by which the property was acquired that it is separate property; or (2) proof that the parties agreed in writing that the property is separate property.¹⁶² In Family Code § 2580, the Legislature specified that these provisions do not apply to property settlement agreements executed before January 1, 1987, or to proceedings in which judgments were rendered before January 1, 1987, regardless of whether those judgments had become final.¹⁶³

*Kane v. Huntley Financial*¹⁶⁴ illustrates the risk of not recording a notice of pendency of action at the beginning of a marriage dissolution case where there is a dispute concerning ultimate ownership of any real property. In *Kane*, the spouses had acquired a residence, taking title in joint tenancy form.¹⁶⁵ Shortly afterward, the wife paid off the existing mortgage, and the husband orally agreed that the property would be her separate property.¹⁶⁶ However, the joint tenancy record title remained unchanged.¹⁶⁷

The wife later filed a dissolution action.¹⁶⁸ While it was pending, the husband applied for a loan from Huntley Financial, representing that he was married and living with his wife in the residence (the “living together” part was untrue).¹⁶⁹ The lender approved a \$12,000 loan, and the husband executed a deed of trust purporting to encumber the entire interest in the residence as security for his note.¹⁷⁰ The wife had no knowledge of this loan

161. Cal. Fam. Code Ann. § 2581 (West 2004 & Supp. 2008).

162. *Id.*; see *infra* pt. IV.C.7 regarding the requirements for transmutation.

163. Cal. Fam. Code Ann. § 2580. The statute’s reference to a “written agreement” seems to be intended to apply only to a prenuptial agreement or marital settlement agreement, because the requirements for a transmutation are more rigorous.

164. *Kane v. Huntley Fin.*, 194 Cal. Rptr. 880 (Cal. App. 4th Dist. 1983).

165. *Id.* at 881.

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Kane*, 194 Cal. Rptr. at 881.

transaction and subsequently asked the trial court to declare the deed of trust invalid. The trial court upheld the validity of the deed of trust, and the wife appealed.¹⁷¹

In its majority opinion, the *Kane* court noted that the wife had failed to protect her separate property claim by failing to record a *lis pendens* (also known as a “notice of pendency of action”) to give constructive notice to any encumbrancer of the pending title dispute.¹⁷² The judgment in the dissolution proceeding declaring the residence to be her separate property was not entered until after the deed of trust to the lender had been recorded, so the beneficiary of the deed of trust was a bona fide encumbrancer.¹⁷³

In a footnote, the *Kane* court observed that the real property had been acquired prior to January 1, 1975, at which time the community property presumption applied “unless a different intention is expressed in the instrument [of acquisition].”¹⁷⁴ The court also stated in that footnote that since the property had been acquired in joint tenancy form, a different intent was expressed, and the community property presumption did not apply.¹⁷⁵

The court held that if the residence had been community property, the entire property would (under the law as it then existed) be subject to execution for the husband’s debt.¹⁷⁶ But “if the property was held in joint tenancy, the wife’s separate property one-half interest would not be liable for her husband’s debts.”¹⁷⁷ The court concluded that under the case law, the wife’s lack of consent precluded the husband from encumbering the entire property, and he could instead encumber only his own interest.¹⁷⁸ His interest was a one-half interest as a joint tenant, so the encumbrance on the property could attach only to his apparent one-half interest.¹⁷⁹

5. *Characteristics of Separate Property*

When community property law was brought into the U.S., largely through adoption from Spain and Mexico, a second, con-

171. *Id.*

172. *Id.* at 882.

173. *Id.*

174. *Id.* at 883 n. 2.

175. *Id.*; but see *In re Marriage of Haines*, 39 Cal. Rptr. 2d 673, 682 (Cal. App. 4th Dist. 1995) (reaching a contrary result on this point).

176. *Kane*, 194 Cal. Rptr. at 882.

177. *Id.*

178. *Id.*

179. *Id.* at 883.

comitant doctrine accompanied it, namely that each of the spouses could also have separate property.¹⁸⁰ In community property states, “separate property” is that which belongs to one spouse alone, and which that spouse can control, sell, or otherwise convey, gift, encumber, or dispose of by will or trust without the consent or joinder of the other spouse.¹⁸¹ Because of the presumption that all property acquired by the spouses during the marriage is community property, countries and states that adopted the community property system found it necessary to specifically delineate what is separate property, in order to make clear which categories of property are not subject to the community property presumption.

Separate property is often described as property owned by a person before marriage or acquired after marriage by gift or inheritance.¹⁸² However, as noted below, the categories are in fact broader. In California, the doctrine is codified in Family Code § 770 and in the California Law Revision Comment to § 760.¹⁸³

In California, the categories of separate property include:

1. All property owned before marriage.
2. All property acquired by the person after marriage by gift, bequest, devise, or descent.
3. The rents, issues, and profits of separate property.¹⁸⁴
4. Earnings and accumulations while living separate and apart.¹⁸⁵
5. Earnings and accumulations after entry of a judgment of legal separation.¹⁸⁶
6. Personal injury damages in which the cause of action arose while the injured person was living separate and apart from the other spouse, or after the entry of a judgment of dissolution of marriage or legal separation.¹⁸⁷ As noted above, the court in the recent *Klug* case extended this statutory rule to a claim for legal

180. *In re Marriage of Baragry*, 140 Cal. Rptr. 779, 781 (Cal. App. 2d Dist. 1977).

181. See e.g. Witkin, *supra* n. 40, at §§ 5–6; Cal. Fam. Code Ann. §§ 752, 770(a), 771(a) (West 2004 & Supp. 2008); Cal. Prob. Code Ann. § 6100 (West 1991 & Supp. 2008); Reppy & Samuel, *supra* n. 9, 5-2 to 5-4; *In re Est. of Clark*, 271 P. 542 (Cal. Dist. App. 1928); de Funiak & Vaughn, *supra* n. 46, at 114–232.

182. de Funiak & Vaughn, *supra* n. 46, at 114–15.

183. Cal. Fam. Code Ann. §§ 760, 770.

184. *Id.* at § 770.

185. *Id.* at § 771. However, the separation must not be a simply temporary one, but must be “real.” *Baragry*, 140 Cal. Rptr. at 781.

186. Cal. Fam. Code Ann. § 772.

187. *Id.* at § 781.

malpractice,¹⁸⁸ so it presumably also extends to other tort-based recoveries. The court in *Klug* also relied on California Family Code § 2556, dealing with division of omitted assets.¹⁸⁹ Section 2603 refers only to a “cause of action for the damages” without limiting the nature of the cause of action or referring to when it arose.¹⁹⁰

7. Property that has been *transmuted* from community property to separate property by written agreement of the parties.¹⁹¹

8. Property acquired by a married woman prior to January 15, 1975, in her name alone, by an instrument in writing. Such property is presumed to be the woman’s own separate property.¹⁹² That presumption is, however, limited to acquisitions made prior to January 15, 1975, and no longer applies to later property acquisitions.¹⁹³

6. What Constitutes a “Separation” for Purposes of Characterizing Post-Separation Earnings as Separate Property?

California Family Code § 771 and its predecessors have long provided that the earnings of a spouse “while living separate and apart from the other spouse” are his or her separate property.¹⁹⁴ For this purpose, the separation must be “real.” Courts generally require that at least one party have an intention to end the marriage and not return to the other spouse, and that his or her conduct evidence that intention.¹⁹⁵

The most extreme example is *In re Marriage of Baragry*.¹⁹⁶ There, the earning physician separated from his wife and lived with his girlfriend for four years.¹⁹⁷ But during that entire period, he took the wife out to social occasions, sent her numerous birthday and anniversary cards, filed an enrollment card at their daughter’s school stating (falsely) that the girl lived at home with

188. *In re Marriage of Klug*, 31 Cal. Rptr. 3d 327, 334 (Cal. App. 3d Dist. 2005).

189. *Id.* at 332.

190. Cal. Fam. Code Ann. § 2603.

191. *Id.* at §§ 850–53 (*see infra* pt. IV.C.7 regarding the requirements for such a transmutation).

192. Cal. Civ. Code Ann. § 5110 (West 1970).

193. Cal. Fam. Code Ann. § 803 (West 2004 & Supp. 2008).

194. Cal. Fam. Code Ann. § 771; Cal. Civ. Code Ann. § 5118 (West 1970 & Supp. 1982).

195. *See e.g. In re Marriage of Norviel*, 126 Cal. Rptr. 2d 148, 160 (Cal. App. 6th Dist. 2002) (Bamattre-Manoukian, J., dissenting).

196. *In re Marriage of Baragry*, 140 Cal. Rptr. 779 (Cal. App. 2d Dist. 1977).

197. *Id.* at 780.

both parents, filed joint income tax returns, paid all household bills, and supported his family.¹⁹⁸ He even brought his laundry to his wife's home while he was living with the girlfriend.¹⁹⁹ When divorce finally ensued, he claimed all his post-separation earnings were his separate property.²⁰⁰ The court rejected his "polygamous lifestyle" and said no separation had occurred until the divorce action was filed.²⁰¹ Thus, a separation must be "real" in order for post-separation earnings to constitute separate property.

7. *Transmutation of Separate Property to Community or Vice Versa*

The term "transmutation" is a term of art under California law.²⁰² It is used to describe a transformation of separate property into community property or vice-versa.²⁰³ The California legislature and California courts apparently adopted this terminology because the alternative term, "conversion," connotes a civil theft.²⁰⁴

Prior to 1984, spouses in California could *orally* transmute their respective properties from separate to community and vice versa.²⁰⁵ This gave rise to a great deal of suspect testimony in marriage dissolution cases—it became virtually customary for a spouse who had the lesser share of property to claim that the other spouse had orally agreed to transmute his or her separate property into community property. This became known colloquially as the "pillow talk rule."

In 1984, the California Legislature changed the law to require a written agreement in order to effect a transmutation, whether the property involved was real property or personal property.²⁰⁶ The present transmutation statute contained in the Family Code states: "A transmutation of real or personal property is not valid unless made in writing by an *express declaration* that is made,

198. *Id.* at 781.

199. *Id.*

200. *Id.*

201. *Id.* at 782.

202. Cal. Fam. Code Ann. § 850 (West 2004 & Supp. 2008).

203. *Id.*

204. *Black's Law Dictionary*, 356–57 (Bryan A. Garner ed., 8th ed., West 2004).

205. *Luders v. Pummer*, 313 P.2d 38, 39 (Cal. App. 2d Dist. 1957); *In re Bernatas*, 328 F.2d 539, 541 (Cal. Dist. App. 1958).

206. Cal. Civ. Code Ann. § 5110.730 (West 1984).

joined in, consented to, or accepted by the spouse whose interest in the property is adversely affected.”²⁰⁷

The leading illustrative case is *Estate of MacDonald*.²⁰⁸ There, the husband had deposited community funds into a bank retirement account, and the wife had signed a form providing “consent of a spouse.”²⁰⁹ The parties knew the wife was then dying of cancer and had agreed to divide their respective properties so there would be no co-owned property at the time of her death.²¹⁰ The California Supreme Court held that the mere consent provision did not effect a transmutation because there was no “express declaration” as required by the statute.²¹¹ While the Court stopped short of requiring specific reference to a “transmutation,” “community property,” or “separate property,” it held that the intent must be clear.²¹² For example, a party could state, “I give to the account holder any interest I have in the funds deposited in this account.”²¹³

The requirements of the transmutation statute are strictly construed. In *In re Marriage of Benson*,²¹⁴ the parties had entered into an oral transmutation agreement, which had been partly performed.²¹⁵ The California Supreme Court ruled that the part performance was not sufficient to satisfy the requirement of the statute²¹⁶ that a transmutation is not valid unless made in writing.²¹⁷ The Court determined that the legislature had intentionally imposed strict standards for transmutations in order to reduce disputes and perjury in marriage dissolution proceedings.²¹⁸ These standards are more rigorous than those imposed by the statute of frauds.²¹⁹

The provisions of this transmutation statute can be a trap, because actions a layman might regard as sufficient to demonstrate intent may fail to meet the statutory requirements. For ex-

207. Cal. Fam. Code Ann. § 852(a) (West 2004 & Supp. 2008) (formerly Cal. Civ. Code Ann. § 5110.730) (emphasis added).

208. *In re Est. of MacDonald*, 794 P.2d 911 (Cal. 1990).

209. *Id.* at 918.

210. *Id.* at 913.

211. *Id.* at 919.

212. *Id.*

213. *Id.*

214. *In re Marriage of Benson*, 116 P.3d 1152 (Cal. 2005).

215. *Id.* at 1154.

216. *Id.*; Cal. Fam. Code Ann. § 852(a) (West 2004 & Supp. 2008).

217. *Benson*, 116 P.3d at 1154.

218. *Id.* at 1156.

219. *Id.* at 1160.

ample, an instruction by one spouse to “journal” stock in his stock brokerage account into the other spouse’s brokerage account was held insufficient to constitute a transmutation because it did not expressly state that the characterization or ownership of the properties was to be changed, and instead appeared to refer only to the brokerages’ internal recordkeeping.²²⁰

Likewise, a recital in a husband and wife family trust providing, “[s]ettlors declare that any community property transferred to the Trust shall retain its character as such, notwithstanding the transfer to the Trust,” was also held insufficient to establish a transmutation of husband’s substantial separate property into community property.²²¹ The court concluded that the trust’s purposes were to avoid probate and provide for orderly administration, and that no provision of the trust contained the required express declaration that the husband was unambiguously effecting a change of ownership in his separate property estate.²²²

At the same time, a valid transmutation can be made under circumstances which may initially seem doubtful. In *In re Roosevelt*,²²³ the Ninth Circuit applied California law to determine whether a marital agreement constituted a fraudulent conveyance under the Bankruptcy Act. The parties had purchased a residence, taking title in joint tenancy. When the marriage began to disintegrate, they executed a marital agreement which divided all of their community property and provided that their residence would be changed into the wife’s separate property. The provision concerning that property stated: “Steven and Judy agree that [the residence] and any property hereafter acquired by Judy during the marriage by any means including but not limited to purchase, gift, bequest, devise, or descent shall be and remain her separate property.”²²⁴

The court found that under California law the spouses could properly transmute their respective properties by an agreement that complied with the statutes so long as it “contain[ed] language which expressly state[d] that the characterization or ownership of the property [was] being changed.”²²⁵ The transmutation was ac-

220. *In re Marriage of Barneson*, 81 Cal. Rptr. 2d 726, 731 (Cal. App. 1st Dist. 1999).

221. *In re Marriage of Starkman*, 28 Cal. Rptr. 3d 639, 641 (Cal. App. 2d Dist. 2005).

222. *Id.* at 643.

223. *In re Roosevelt*, 87 F.3d 311 (9th Cir. 1996), *overruled on other grounds*, *In re Banner*, 131 F.3d 788 (9th Cir. 1997).

224. *Id.* at 313–15 (emphasis omitted).

225. *Id.* at 314 (citing *In re Est. of MacDonald*, 794 P.2d 911, 918 (Cal. 1990)).

cordingly held not to constitute a fraudulent conveyance, and not to bar a discharge of the husband in bankruptcy.²²⁶

A quitclaim deed from one spouse to the other is often used by California lawyers to effect a relinquishment by one spouse of a property interest in real property previously owned (or claimed) by both spouses. The older opinion in *In re Marriage of Broderick*²²⁷ upheld a quitclaim deed from wife to husband, even though the husband paid her only \$3,000 in exchange for her half interest in the family home, which was worth over \$13,000.²²⁸ It seems doubtful that the same result would follow today. In *Haines*, the court voided a similar quitclaim deed on the ground that the husband exercised undue influence in violation of his fiduciary duties.²²⁹

If there is any hint of overreaching or bad faith, such a quitclaim deed is likely to be set aside. In the wake of *MacDonald* and the express provisions of the statute, a quitclaim deed intended to effect a transmutation should probably contain two specific recitals. First, it should state that the property is being conveyed to the other spouse “as his [or her] sole and separate property.”²³⁰ Second, it should recite that the deed is intended to effect a relinquishment of the transferor’s interest in the property.²³¹

Notwithstanding the ambiguity of the case law, California title companies will still ordinarily insure title in one spouse, based on a quitclaim deed from the other spouse, if the quitclaim was given within some specified period of time (usually not more than five years). If the quitclaim deed is older than that, many title companies will insist on a new quitclaim deed being recorded before they will insure title. Title companies are, however, increasingly discouraging use of quitclaim deeds. Instead, the companies ask that parties who wish to effect such a transfer use a grant deed, because it transfers after-acquired title.

226. *Id.* at 318–19. In denying rehearing, the Court made a number of small changes in its opinion, but they do not seem to affect the transmutation issue. See *Booker v. Edwards*, 99 F.3d 1169 (D.C. Cir. 1996).

227. *In re Marriage of Broderick*, 257 Cal. Rptr. 397, 403.

228. *Id.* at 403.

229. *In re Marriage of Haines*, 39 Cal. Rptr. 2d 673, 689 (Cal. App. 4th Dist. 1995).

230. *MacDonald*, 794 P.2d at 919.

231. *Id.*

8. *The “Sandwich” Problem: When One Spouse Expend Personal Efforts or Community Assets during Marriage to Improve or Increase Value of Other Spouse’s Separate Property*

In *In re Marriage of Moore*,²³² the wife made the down payment on the purchase of a house, but community funds were used to make subsequent payments on the mortgage loan.²³³ The California Supreme Court ruled that where community funds were used to make payments on property purchased by one of the spouses before marriage, “the rule developed through decisions in California gives to the community a *pro tanto* community property interest in such property in the ratio that the payments on the purchase price with community funds bear to the payments made with separate funds.”²³⁴ In other words, use of the community funds creates a community property “layer” in the property “sandwich.”

Effective January 1, 1984, the California Legislature adopted former Civil Code § 4800.2, which allows reimbursement to be made before community property is divided, for any separate property contribution made to property that is later to be divided as community property.²³⁵ In *In re Marriage of Fabian*,²³⁶ the California Supreme Court held this statute could not be applied retroactively, because to do so would be a violation of due process.²³⁷ Subsequently, the California Legislature amended the statute to provide that it would only apply prospectively.²³⁸ In *In re Marriage of Heikes*,²³⁹ the California Supreme Court held the reimbursement statute was “limited by the due process clause to property acquired on or after January 1, 1984.”²⁴⁰ When either spouse’s separate property funds are invested in community assets, the party claiming the benefit of the contribution must provide adequate evidence by tracing the property (typically separate property) so invested.²⁴¹

232. *In re Marriage of Moore*, 618 P.2d 208 (Cal. 1980).

233. *Id.* at 209.

234. *Id.* at 210 (quoting *Forbes v. Forbes*, 118 Cal. App. 2d 324, 325 (1953) (emphasis added)).

235. Cal. Civ. Code Ann. § 4800.2 (West 1984).

236. *In re Marriage of Fabian*, 715 P.2d 253 (Cal. 1986).

237. *Id.* at 260.

238. Cal. Civ. Code Ann. § 4800.2.

239. *In re Marriage of Heikes*, 899 P.2d 1349 (Cal. 1995).

240. *Id.* at 1358.

241. See e.g. *In re Marriage of Aufmuth*, 152 Cal. Rptr. 668, 674 (Cal. App. 1st Dist. 1979) (superseded by statute); *In re Marriage of Allen*, 116 Cal. Rptr. 2d 887, 893 (Cal. App.

The “sandwich” problem also arises when one spouse exercises personal efforts to improve the value of separate property owned by the other spouse. This may, for example, arise through one spouse’s management of the other spouse’s separate property business, stock portfolio, or real property. In each instance, the question is how much of the appreciation is to be allocated to the separate property owned by one spouse and how much is to be allocated to the spouse who has performed the value-increasing work.²⁴²

California courts have adopted two alternative case-law approaches to determine the community property share. First, under *Pereira v. Pereira*,²⁴³ the court may simply allocate to the separate property a reasonable rate of return on the original investment and allocate any increase above that amount to community property.²⁴⁴ Alternatively, as demonstrated in *Van Camp v. Van Camp*,²⁴⁵ the court may determine the reasonable value of the community services and allocate that amount to the community, treating the balance as separate property attributable to the inherent nature of the estate.²⁴⁶

In *In re Marriage of Folb*,²⁴⁷ the California Court of Appeals used the *Pereira* approach and a twelve percent rate of return to determine the value of the husband’s separate property invested capital.²⁴⁸ It did so in substantial part because it found that the husband was an “unusually skillful developer of raw land,” and that his personal efforts and management (which were community property) were responsible for most of the increase in value.²⁴⁹ The Nevada Supreme Court also adopted the *Pereira* apportionment formula in *Cord v. Neuhoﬀ*.²⁵⁰

In *Beam v. Bank of America*,²⁵¹ the California Supreme Court held that “[i]n making an apportionment between separate and community property, [the California courts have] developed ‘no precise criterion or fixed standard, but have endeavored to adopt a

2d Dist. 2002) (holding community entitled to reimbursement of community funds used to make improvements on husband’s separate property residence).

242. *Beam v. Bank of America*, 490 P.2d 257, 261 (Cal. 1971).

243. *Pereira v. Pereira*, 103 P. 488 (Cal. 1909).

244. *Id.* at 491.

245. *Van Camp v. Van Camp*, 199 P. 885 (Cal. Dist. App. 1921).

246. *Id.* at 889–90.

247. *In re Marriage of Folb*, 126 Cal. Rptr. 306 (Cal. App. 2d Dist. 1975).

248. *Id.* at 314.

249. *Id.*

250. *Cord v. Neuhoﬀ*, 573 P.2d 1170, 1173 (Nev. 1978).

251. *Beam v. Bank of Am.*, 490 P.2d 257 (Cal. 1971).

yardstick which is most appropriate and equitable in a particular situation.’ ”²⁵² The *Beam* Court also said that the proper formula depends on “whether the character of capital investment in the separate property or the personal activity, ability, and capacity of the spouse is the chief contributing factor in the realization of income and profits.”²⁵³ In *In re Marriage of Lopez*,²⁵⁴ the California Court of Appeal said the *Van Camp* formula is the appropriate one when the “husband’s efforts had a minor influence on the growth of the investment.”²⁵⁵

V. PROPERTY ACQUIRED IN MONTANA WITH COMMUNITY-SOURCE PROPERTY REMAINS COMMUNITY PROPERTY, EVEN THOUGH NOT HELD OF RECORD AS SUCH

A. *Constitutional Law Cases*

1. *The California Cases*

The California constitutional cases arose in the context of an enactment (then-Civil Code § 4800.1)²⁵⁶ that was intended to apply retroactively and materially changed the existing law. The enactment provided that the only means of rebutting the presumption that the property acquired during marriage and held in joint tenancy form was community property was by providing evidence of a written agreement that the property was separate property.²⁵⁷ In *Buol*, the California Supreme Court determined, “retroactive application of section 4800.1 would operate to deprive [the wife] of a *vested property right without due process of law*. At the time of trial, [the wife] had a vested property interest in the residence as her separate property.”²⁵⁸

In reaching its decision, the *Buol* Court stated, “[d]estroying enforcement of a vested right is . . . tantamount to destroying the right itself.”²⁵⁹ It also added, “[i]nsofar as it applies retroactively,

252. *Id.* at 261 (quoting *Logan v. Forster*, 114 Cal. App. 2d 587, 599–600 (1952)).

253. *Id.* (quoting *Logan*, 114 Cal. App. 2d at 599–600) (internal citations omitted).

254. *In re Marriage of Lopez*, 113 Cal. Rptr. 58 (Cal. App. 3d Dist. 1974).

255. *Id.* at 66.

256. Cal. Civ. Code Ann. § 4800.1 (West 1984).

257. *Id.*

258. *In re Marriage of Buol*, 705 P.2d 354, 357 (Cal. 1985) (citing Cal. Const. art. I, § 7) (emphasis added). At that time, spouses could convert separate property into community or vice versa by oral agreement. That is no longer the law of California.

259. *Id.* at 358 (quoting *Baldwin v. City of San Diego*, 15 Cal. Rptr. 576, 578 (Cal. Dist. App. 1961)).

the statute imposes an irrebuttable presumption barring recognition of the vested separate property interest.”²⁶⁰ The Court’s discussion of the issues seems to indicate the character of the property right was vested prior to the legislative enactment. That rationale is equally applicable to an interest in community property, since the two categories of property are the essential components of the California community property system. The statute considered in *Buol* provided that it was applicable to all property divisions that were not yet final on January 1, 1984.²⁶¹ In *Buol*, the judgment dividing the community property had been entered, but was not yet final on January 1, 1984.²⁶²

Similarly, in *Fabian*, the California Supreme Court also held retroactive application of former Civil Code § 4800.2 to cases pending on January 1, 1984, “impair[ed] vested property interests without due process of law.”²⁶³

In *Heikes*, the California Supreme Court dealt with the right to reimbursement when a couple separates.²⁶⁴ In *Heikes*, the husband conveyed an unimproved parcel to himself and his wife as joint tenants in 1976.²⁶⁵ At that time, the community property presumption relating to a joint tenancy property applied only to a “single family residence” and not to unimproved land.²⁶⁶ The California Supreme Court stated that:

In *Buol*, we held that the provision of [Civil Code] section 4800.1 requiring a writing to rebut the presumption that property acquired in joint tenancy is community property could not constitutionally be applied to deprive Mrs. Buol of her vested property interest without due process of law. Here, however, *Buol* does not preclude retroactive application of section 4800.1’s presumption that the unimproved parcel conveyed by husband to himself and wife in joint tenancy is community property, because husband held no vested property right, as joint tenant of the parcel, that he would not also have held as owner of a community property interest while both spouses were still alive.²⁶⁷

Thus, the doctrine of a constitutionally protected, vested property interest was applied to a *community property interest*. At the time of the *Heikes* decision, California had adopted another stat-

260. *Id.* at 359.

261. *Id.* at 356 (citing Cal. Civ. Code Ann. § 4800.1).

262. *Id.*

263. *In re Marriage of Fabian*, 715 P.2d 253, 260 (Cal. 1986) (emphasis added).

264. *In re Marriage of Heikes*, 899 P.2d 1349, 1349–50 (Cal. 1995).

265. *Id.* at 1350.

266. *Id.* at 1352.

267. *Id.*

ute, former Civil Code § 4800.2, which required reimbursement for separate property contributions made to the acquisition of any property the court later divided as community property in a dissolution proceeding.²⁶⁸ In *Heikes*, the husband transferred two unimproved parcels to his wife and himself in joint tenancy. This transaction changed the property to community property in anticipation of a dissolution. He attempted to claim a reimbursement under section 4800.2.²⁶⁹

As noted above, the Court in *Buol* stated, “[t]he status of property as community or separate is normally determined at the time of its acquisition.”²⁷⁰ The *Buol* Court also overruled five prior California cases that held the contrary.²⁷¹

2. *The Respective Constitutional Provisions*

The Fifth Amendment to the U.S. Constitution provides in time-honored language that “[n]o person shall . . . be deprived of life, liberty or property without due process of law.”²⁷² The Fourteenth Amendment in turn provides, “nor shall any state deprive any person of life, liberty, or property, without due process of law.”²⁷³

The California constitutional provision on which the *Buol* Court relied states, “[a] person may not be deprived of life, liberty or property without due process of law or denied equal protection of the laws.”²⁷⁴ Likewise, the Montana Constitution, in article II, section 17 provides that “[n]o person shall be deprived of life, liberty, or property without due process of law.”²⁷⁵

3. *The Federal Constitutional Cases*

The above-quoted California cases unequivocally establish that a community property interest is, under California state law, a constitutionally protected property interest. State law determines the nature and extent of the property interest for federal due process purposes. In *Dunbar Corporation v. Lindsey*,²⁷⁶ plain-

268. Cal. Civ. Code Ann. § 4800.2 (West 1984).

269. *Heikes*, 899 P.2d at 1352–53.

270. *In re Marriage of Buol*, 705 P.2d 354, 357 (Cal. 1985) (internal citations omitted).

271. *Id.* at 362 n. 10.

272. U.S. Const. amend. V.

273. U.S. Const. amend. XIV.

274. Cal. Const. art. 1, § 7.

275. Mont. Const. art. II, § 17.

276. *Dunbar Corp. v. Lindsey*, 905 F.2d 754 (4th Cir. 1990).

tiff Dunbar asserted that various representatives of the U.S. had unconstitutionally seized possession of its land without due process in violation of the Fifth Amendment.²⁷⁷ The property at issue was located in North Carolina.²⁷⁸ The court stated:

Under the first inquiry, North Carolina law determines whether Dunbar has any property rights protected by the Fifth Amendment's Due Process Clause. . . .

Under the second inquiry, it is plain that the Due Process Clause does not safeguard only the rights of undisputed ownership. Instead, it has been read broadly to extend protection to any significant property interest. . . . Due process "extends to property rights less substantial than full legal title. . . . Even a merely arguable right to possession constitutes property."²⁷⁹

Research to date has not disclosed any U.S. Supreme Court cases dealing with an individual's interest in community property, other than cases that dealt expressly with federal preemption of state law.²⁸⁰ For example, in *Emard v. Hughes Aircraft Co.*,²⁸¹ the Ninth Circuit stated, "[i]n *Ingersoll-Rand Co. v. McClendon* . . . the [Supreme] Court stated that 'a state law may "relate to" a benefit plan, and thereby be preempted, even if the law is not specifically designed to affect such plans, or the effect is only indirect.'"²⁸² The California courts have recognized that Social Security benefits are governed exclusively by the Social Security Act and that treating them as divisible community property assets would be forbidden by the Supremacy Clause.²⁸³

The Fourteenth Amendment to the U.S. Constitution has long been interpreted to apply the requirements of the Fifth Amendment to State action, including the Equal Protection Clause.²⁸⁴ In

277. *Id.* at 755.

278. *Id.*

279. *Id.* at 760 (internal citations omitted).

280. See e.g. *Boggs v. Boggs*, 520 U.S. 833, 836 (1997) (holding that Louisiana's law of community property conflicted with, and therefore was preempted by, ERISA's survivor's annuity and anti-alienation provisions and by ERISA's definition of "beneficiary"); see also *Emard v. Hughes Aircraft Co.*, 153 F.3d 949, 962 (9th Cir. 1998) (recognizing a spouse's one-half community property interest in the proceeds of life insurance policies that were purchased with community property funds and holding that ERISA preemption did not preclude application of California's law of constructive trusts or its law of community property) (abrogated by *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141 (2001)).

281. *Emard v. Hughes Aircraft Co.*, 153 F.3d 949, 962 (9th Cir. 1998).

282. *Emard*, 153 F.3d at 953 (quoting *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 139 (1990)).

283. *In re Marriage of Nizenkoff*, 135 Cal. Rptr. 189, 192 (Cal. App. 1st Dist. 1976).

284. See e.g. *Shelley v. Kraemer*, 334 U.S. 1, 13-14 (1948) (striking down racial covenants in real estate); *N.Y. Times Co. v. Sullivan*, 376 U.S. 254, 264 (1964) (holding Alabama's common law of libel is a state action that must comply with the First Amendment);

Kirchberg v. Feenstra,²⁸⁵ the U.S. Supreme Court struck down a Louisiana statute that made the husband “head and master” of property held jointly with his wife and permitted him to dispose of such property without the wife’s consent.²⁸⁶ The Court held this statute constituted gender-based discrimination in violation of the Equal Protection Clause of the Fourteenth Amendment.²⁸⁷

It appears that under Montana law, state action is inherently involved in a marriage dissolution action, even if the action is resolved by agreement. The Montana Code contemplates that the court will evaluate a settlement agreement to determine that the agreement is “not unconscionable.”²⁸⁸ However, this criteria is applicable only if the property division is resolved by agreement. If there is no such agreement, the court must itself make the division, in which case the “equitable apportionment” standard provided by Montana Code Annotated § 40-4-202 governs.²⁸⁹

Based on the above authorities, it is respectfully submitted that any action by a Montana court which endeavored to deprive either a husband or a wife of his or her respective previously-vested community property interest, without the requisite prior notice that the community interested was being affected, would violate both due process and equal protection.

*B. Non-Constitutional State Cases Confirming That
Community Property Character Is Not Lost When
Spouses Move Property to a Common
Law State*

In *Tomaier v. Tomaier*,²⁹⁰ spouses who were residents in California used community property funds to purchase land in Missouri, taking title to the Missouri property in joint tenancy.²⁹¹ The California Supreme Court held:

Brown v. Bd. of Educ., 347 U.S. 483, 494–95 (1954); see also Erwin Chemerinsky, *Constitutional Law: Principles and Policies* 478–510, 648–82 (2d ed., Aspen 2002).

285. *Kirchberg v. Feenstra*, 450 U.S. 455 (1981).

286. *Id.* at 461–63.

287. *Id.* at 459–60; see also *Orr v. Orr*, 440 U.S. 268, 283 (1979) (striking down a state statute providing husbands, but not wives, may be required to pay alimony upon divorce, as a violation of equal protection).

288. Mont. Code Ann. § 40-4-201 (2007); *In re Marriage of Miller*, 777 P.2d 319, 322–23 (Mont. 1989).

289. *Miller*, 777 P.2d at 322–23.

290. *Tomaier v. Tomaier*, 146 P.2d 905 (Cal. 1944).

291. *Id.* at 906.

The plaintiff should have been permitted to introduce evidence that the property in Missouri, as well as in California, was purchased with community funds with the intention that it remain part of the community. Property rights are not lost simply because property is transported into another state and exchanged there for other property.²⁹²

In *Quintana v. Ordone*,²⁹³ the husband and wife had been married in Cuba, a community property jurisdiction, and had resided there for many years.²⁹⁴ During the marriage, the husband purchased stock in a Florida corporation.²⁹⁵ Upon his death, the widow claimed the stock on the ground that the purchase price had been paid from Cuba-source assets.²⁹⁶ The Florida court held that under the laws of Cuba, ownership of the stock vested not in the husband, in whose sole name the stock had been taken, but instead in the marital community, saying, “[t]hus, the wife had a vested interest in the stock equal to that of her husband. The interest that vested in the wife was not affected by the subsequent change of domicile from Cuba to Florida in 1960.”²⁹⁷

Other common law states have held that a change of domicile and the situs of community *personal* property does not convert the true character of ownership into a common law form. Rather, the property is still community, even though husband and wife have become domiciliaries of a common law state.²⁹⁸ In *State v. Bejarano*,²⁹⁹ the wife claimed rights to pension benefits of the husband after the couple moved from California to Texas and then to Colorado.³⁰⁰ (Both California and Texas are community property states.) The Colorado Court held that “community property retains its characteristics as such when it is remanded to a common law state.”³⁰¹

In *Newman v. Newman*,³⁰² the wife argued that the husband’s military pension had accrued while the couple was domiciled in California even though the husband resided in Mississippi part of

292. *Id.* at 907–08 (internal citations omitted).

293. *Quintana v. Ordone*, 195 So. 2d 577 (Fla. 3d Dist. App. 1967).

294. *Id.* at 578.

295. *Id.*

296. *Id.* at 579.

297. *Id.* at 580.

298. See e.g. *Cmmw. v. Terjen*, 90 S.E.2d 801, 802, 804 (Va. 1956); *In re Kessler's Est.*, 203 N.E.2d 221, 222–23 (Ohio 1964).

299. *State v. Bejarano*, 358 P.2d 866 (Colo. 1961).

300. *Id.* at 867.

301. *Id.* at 868.

302. *Newman v. Newman*, 558 So. 2d 821 (Miss. 1990).

that time.³⁰³ The Mississippi Court seemed to adopt the California approach of pro rata division of the asset to solve the problem of ownership rights, because the asset had been acquired in two jurisdictions over a long period of time.³⁰⁴

VI. APPLICATION OF COMMUNITY PROPERTY LAW TO NONTRADITIONAL RELATIONSHIPS

A. *California Domestic Partnerships*

In 2003, California adopted the California Domestic Partner Rights and Responsibilities Act, which extended almost all of the non-tax rights, responsibilities, and duties enjoyed by married persons to “registered domestic partners” who have filed the requisite declaration with the Secretary of State.³⁰⁵ Although the section dealing with rights, responsibilities, and duties equates those of domestic partners to those of “spouses,”³⁰⁶ the provision for termination (dissolution of a domestic partnership) reflects the underlying legislative intent by referring expressly to community property.³⁰⁷ In 2006 the Legislature deleted the previous income tax distinction,³⁰⁸ so that now California domestic partners may file joint income tax returns, just like a married couple.

Persons eligible to qualify as domestic partners include: (a) persons of the same sex or (b) persons of the opposite sex if one or both is eligible for old-age Social Security benefits and is over sixty-two years of age.³⁰⁹ This latter, age-related provision not only affects potential loss of Social Security benefits but may also affect continuing eligibility for spousal support, which would also be lost by remarriage. Some older adults may also be reluctant to remarry because of the effect on the inheritance rights of children from an earlier union or because of the economic impact on limited retirement assets if a later-life marriage fails.

303. *Id.* at 822–23.

304. *Id.* at 825 n. 1.

305. Cal. Fam. Code Ann. §§ 297–299.6 (West 2004 & Supp. 2008).

306. *Id.* at § 297.5.

307. *Id.* at § 299.6.

308. *In re Marriage Cases*, __ P.3d __, 2008 WL 2051892, *24 (Cal. May 15, 2008).

309. Cal. Fam. Code Ann. § 297(b)(6)(B).

*B. Washington Law: Property Acquired by Unmarried
Persons Treated as Community Property upon
Termination of Relationship*

Washington state courts characterize unmarried cohabitants as participants in a “meretricious relationship.”³¹⁰ The courts do not use this term in a pejorative sense; it is merely descriptive. The Washington Supreme Court determined in *Connell v. Francisco*³¹¹ that once a meretricious relationship is found to have been established by an application of five enumerated factors, then upon termination of the relationship a just and equitable distribution must be made of “property that would have been characterized as community property had the parties been married.”³¹² In so deciding, the Court stated:

We hold income and property acquired during a meretricious relationship should be characterized in a similar manner as income and property acquired during marriage. Therefore, all property acquired during a meretricious relationship is presumed to be owned by both parties. This presumption can be rebutted. All property considered to be owned by both parties is before the court and is subject to a just and equitable distribution. The fact title has been taken in the name of one of the parties does not, in itself, rebut the presumption of common ownership.³¹³

The Court also recognized that property owned by one of the parties before the relationship began and property acquired thereafter by gift, bequest, devise, or descent, or with the rents, issues, and profits thereof, is not before the court for division.³¹⁴ These categories are property which would have been the party’s separate property if a marriage had existed.

Subsequent cases have fine-tuned the *Connell* rule. In *Lindeman v. Lindeman*,³¹⁵ a new business was treated as community property. The man had just begun the business when the relationship started, but the business increased in value during the ten-year relationship.³¹⁶ The court stated that the value increase

310. *Connell v. Francisco*, 898 P.2d 831, 836 (Wash. 1995).

311. *Connell v. Francisco*, 898 P.2d 831 (Wash. 1995).

312. *Id.* at 835–36.

313. *Id.* at 836 (internal citations omitted).

314. *Id.*

315. *Lindeman v. Lindeman*, 960 P.2d 966 (Wash. App. Div. 1 1998).

316. *Id.* at 970, 971.

“was community in character because it had been achieved by [his] community labor.”³¹⁷

In the consolidated cases in *In re Marriage of Pennington*,³¹⁸ the Washington Supreme Court found that the facts did not satisfy the five factors required to establish a protectable meretricious relationship.³¹⁹ The relationships involved were sporadic in nature and accompanied by sexual relationships with third persons, and in one case the woman was still married to another man during the alleged meretricious relationship.³²⁰

The Washington Court of Appeals held in *Olver v. Fowler*³²¹ (*Olver I*) that upon the death of one unmarried cohabitant in a committed relationship, any property acquired during the relationship that would have been community property if the parties were married is jointly owned and subject to a just and equitable division.³²² This is true even though a meretricious partner does not take under the intestacy statutes.³²³

In the subsequent case of *Olver v. Fowler*³²⁴ (*Olver II*), the Washington Supreme Court en banc reaffirmed a 2001 opinion holding that the *Connell* doctrine applies to same-sex relationships.³²⁵ It further held that if both of the same-sex partners are deceased, their jointly acquired property can be equitably divided between their respective estates.³²⁶

It is not clear that a Montana court would be required to honor Washington’s *Connell* doctrine. It does not make the property accumulations of unmarried cohabitants community property; it only treats such accumulations *as if* they were community property. It may well be that the Washington model has much to recommend it, and that its *Connell* doctrine may be adopted in many other states. Nevertheless, a Montana court may elect to apply its own public policy in such situations. The Montana Supreme Court apparently has not yet directly ruled on how to divide the property of unmarried cohabitants when their relation-

317. *Id.* at 973 (drawing very little distinction between married couples and unmarried cohabitants in its use of “community property” language).

318. *In re Marriage of Pennington*, 14 P.3d 764 (Wash. 2000).

319. *Id.* at 772–73.

320. *Id.* at 771–72.

321. *Olver v. Fowler*, 126 P.3d 69 (Wash. App. Div. 1 2006).

322. *Id.* at 76.

323. *Id.* at 74.

324. *Olver v. Fowler*, 168 P.3d 348 (Wash. 2007).

325. *Id.* at 355, 357.

326. *Id.* at 356–57.

ship terminates. Both reported cases that tangentially dealt with the issue³²⁷ did not squarely present the question. In both instances, the parties had ultimately married, thus bringing themselves within the statute, which requires an equitable apportionment upon dissolution of marriage.³²⁸

C. Constitutional Issues in Nontraditional Relationships

Nontraditional relationships, both between cohabitants of opposite sexes and between same-sex partners, are rapidly proliferating across the country. There is, so far, little uniformity in the way various jurisdictions treat the property aspects of these relationships upon termination. However, when the constitutional doctrines discussed above are applied, it is this author's view that the Montana courts would probably feel obligated to respect the California law, which makes the property of registered domestic partners community property. This should follow not only the due process requirements of the California cases discussed *supra*, but also the effect of the Full Faith and Credit Clause of the U.S. Constitution.³²⁹ As Professor Weintraub notes in his Conflict of Laws treatise:

The Full Faith and Credit Clause articulates one respect in which national uniformity is required: one state is not free to ignore the public acts, records, or judicial proceedings of another, not to subject them to the gantlet [sic] of local "public policy", as it may the acts, records, and judicial proceedings of a sovereign with which it is not combined in a federation. In order to determine whether the Full Faith and Credit Clause places a further limitation on a state's choice of law than is imposed by the Due Process Clause, the interest of the state that makes application of its law consistent with due process is to be weighed against the need for national uniformity of result under a public act, record, or judicial proceeding of a sister state.³³⁰

In a landmark case argued on March 4, 2008,³³¹ the California Supreme Court considered the constitutional nature of Cali-

327. *In re Marriage of Rolf*, 16 P.3d 345 (Mont. 2000); *In re Marriage of Clark*, 71 P.3d 1228 (Mont. 2003).

328. *Rolf*, 16 P.3d at 348; *Clark*, 71 P.3d at 1230; Mont. Code Ann. § 40-4-202 (2007).

329. U.S. Const. art. IV, § 1.

330. Russell J. Weintraub, *Commentary on the Conflict of Laws* 666, 666 n. 217 (5th ed., West 2006) (citing Justice Stone's language in *Milwaukee Co. v. M.E. White Co.*, 296 U.S. 268, 276-77 (1935)).

331. *In re Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 (Cal. May 15, 2008); Jud. Council of Cal., *Supreme Court to Hear Oral Arguments in Marriage Cases on March 4, 2008*, <http://www.courtinfo.ca.gov/presscenter/newsreleases/NR05-08.pdf> (Feb. 6, 2008); see *infra* nn. 339-55 and accompanying text for explanation of decision.

ifornia statutes which have long defined marriage as a contract between a man and a woman.³³² The issue was focused even more clearly by a 2000 voter-enacted initiative, which provided: "Only marriage between a man and a woman is valid or recognized in California."³³³

The federal Defense of Marriage Act (DOMA) pushes the envelope somewhat further by specifying, in substance, that no state shall be required to give effect to any law or judicial proceeding in another state "respecting a relationship between persons of the same sex that is treated as a marriage under the laws of such other state."³³⁴ One commentator suggests that this statute is a "doubtful attempt to restrict the effect of the Full Faith and Credit Clause."³³⁵ Another provision of DOMA specifies that "the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."³³⁶

In *Smelt v. County of Orange*,³³⁷ two men who sought to be married in California challenged both the California voter-enacted statute³³⁸ and DOMA as violations of the right to privacy, the Ninth Amendment, the Full Faith and Credit Clause, the Due Process Clause, and the Equal Protection Clause. The Ninth Circuit Court of Appeals noted that no state had determined that they were married, though their situation might change were they to change their residence to Massachusetts³³⁹ (which recognizes same-sex marriages). The court upheld the federal district court's abstention regarding the state statutes, noting that the *In re Marriage Cases*³⁴⁰ were then pending in the California appellate courts,³⁴¹ and held that the plaintiffs lacked standing to challenge DOMA.³⁴² The U.S. Supreme Court denied certiorari.³⁴³

This was the backdrop against which the California Supreme Court heard the *Marriage Cases*, four consolidated cases filed by nearly two dozen gay and lesbian couples and by the City and

332. Cal. Fam. Code Ann. §§ 300, 302 (West 2004 & Supp. 2008).

333. *Id.* at § 308.5.

334. 28 U.S.C. § 1738(c) (2000).

335. Weintraub, *supra* n. 330, at 682 n. 283.

336. 1 U.S.C. § 7 (2006).

337. *Smelt v. Co. of Orange*, 447 F.3d 673 (9th Cir. 2006).

338. Cal. Fam. Code Ann. § 308.5.

339. *Smelt*, 447 F.3d at 677, 683.

340. *In re Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 at *57 (Cal. May 15, 2008).

341. *Smelt*, 447 F.3d at 681.

342. *Id.* at 683.

343. *Smelt v. Orange Co., Cal.*, 127 S. Ct. 396 (2006).

County of San Francisco. The issues presented are currently such hot potatoes that forty-five amicus briefs were filed, and the Court allowed an unprecedented three and one-half hours of oral argument. The following excerpts from the California Bar Journal's April 2008 issue illustrate the scope of the issues considered:

Forty-five amicus briefs were filed in response to the challenge by gay couples and the City and County of San Francisco to the state prohibition on same-sex marriages, arguing everything from the necessity to take into account a transformed culture to California's role as a bellwether state to the absence of standing by San Francisco to file suit at all.

The briefs came from prominent legal scholars, legislators, civil rights and gay rights organizations, city and county governments, churches, bar associations and a former state Supreme Court justice. Of the 45 briefs, 29 supported gay marriage, 14 opposed it and one took no position but admonished the court not to base its decision on popular sentiment.

* * *

One group of law professors wrote of the interstate confusion and problems created when a marriage recognized in one state is not recognized in another. . . .

But most of the other briefs touched on the larger issues highlighted by the justices: whether same-sex marriage amounts to a fundamental right and whether the state has to meet a higher standard to deny that right; whether marriage and domestic partnerships are comparable; whether the courts or legislative process should decide gay marriage; whether tradition is a good enough reason to maintain the current definition of marriage; whether a court decision 60 years ago to lift the ban on interracial marriage corresponds to the marriage right being sought by gays and lesbians and whether the ban on same-sex marriage amounts to gender discrimination.

* * *

Former Stanford Law School Dean Kathleen Sullivan, arguing for 17 constitutional law professors, countered the state's prime argument that tradition demands the continued definition of marriage as that between a man and a woman. Using that argument, Sullivan wrote, courts would not have desegregated schools or opened doors to women. "Across a wide range of issues . . . constitutional interpretation has taken into account changed social circumstances and cultural understandings," she wrote.

Others spoke to the issue of the justification—or not—for gay marriage when domestic partnerships are a fact of life in California

. . . .

* * *

In a different brief, Pepperdine University School of Law's Douglas Kmiec and five other law professors supporting marriage

as it currently stands denied that refusing to allow gays and lesbians to marry amounts to sex discrimination. "As the overwhelming majority of courts have held over the past decade . . . marriage laws do not distinguish on the basis of sex, but rather treat men and women equally."

* * *

As for the judiciary's role in deciding gay marriage, which was a topic of concern for several justices, friends-of-the-court briefs divided on the lines of those who favor gay marriage and those who don't. "The judiciary should not innovate social policy," wrote Washington-based Judicial Watch Inc. "Statutes are presumed constitutional and must not be annulled unless the constitutional conflict is clear, positive and unquestionable."³⁴⁴

Only rarely have so many diverse positions been presented to the highest court of a state.

On May 15, 2008, in a massive 121-page opinion, Chief Justice George held that California Family Code §§ 300 and 308.5, which together prohibited same-sex couples from marrying in California, violated the California Constitution.³⁴⁵ The Court found the statutes violated three separate provisions of the California Constitution, being: (1) the privacy clause, which the Court interpreted as guaranteeing the right to marry the person of one's choice;³⁴⁶ (2) the liberty interest protected by the due process clause;³⁴⁷ and (3) the equal protection clause.³⁴⁸

With respect to the first two points, the Court stated:

[S]ections 1 and 7 of article I of the California Constitution cannot properly be interpreted to withhold from gay individuals the same basic civil right of personal autonomy and liberty (including the right to establish, *with the person of one's choice*, an officially recognized and sanctioned family) that the California Constitution affords to heterosexual individuals. The *privacy* and *due process* provisions of our state Constitution—in declaring that "[a]ll people . . . have [the] inalienable right [of] privacy (art. I, § 1) and that no person may be deprived of "liberty" without due process of law (art. I, § 7)—do not purport to reserve to persons of a particular sexual orientation the substantive protection afforded by these provisions. In light of the evolution of our state's understanding concerning the equal dignity and respect to which all persons are entitled without

344. Diane Curtis, *No Shortage of Advice on Same Sex Marriage Case*, Cal. St. B.J. 1, 7 (Apr. 2008).

345. *Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 at *57.

346. Cal. Const. art. I, § 1; *Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 at *26, 32, 34.

347. Cal. Const. art. I, § 7; *Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 at *26, 32, 34.

348. Cal. Const. art. I, § 7; *Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 at *57.

regard to their sexual orientation, it is not appropriate to interpret these provisions in a way that, as a practical matter, excludes gay individuals from the protective reach of such basic civil rights.³⁴⁹

In its equal protection analysis, the Court concluded:

[S]exual orientation should be viewed as a *suspect classification* for purposes of the California Constitution's equal protection clause and . . . statutes that treat persons differently because of their sexual orientation should be subject to *strict scrutiny* under this constitutional provision.³⁵⁰

The Court held that:

[R]etention of the traditional definition of marriage does not constitute a state interest sufficiently compelling, under the strict scrutiny equal protection standard, to justify withholding that [marriage] status from same-sex couples.³⁵¹

In reaching its conclusion, the Court relied heavily³⁵² on its 1948 decision in *Perez v. Sharp*,³⁵³ which held unconstitutional a California statute prohibiting interracial marriage.³⁵⁴ The Court observed that *Perez* was decided twenty years before the U.S. Supreme Court reached the same conclusion under the federal Constitution in *Loving v. Virginia*.³⁵⁵

Justice Baxter dissented on the ground that the majority opinion violates the separation of powers doctrine.³⁵⁶ This dissent also noted that the high court of Massachusetts is the only other American court to have ruled that its state constitution gives the right of civil marriage to same-sex partners, whereas eight other states (Maryland, New York, Washington, Indiana, Arizona, Minnesota, New Jersey, and Vermont) and the District of Columbia have rejected claims of state constitutional rights to same-sex marriages.³⁵⁷ The majority opinion recognized that the Supreme Judicial Court of Massachusetts reached its opinion "by a closely

349. *Marriage Cases*, __ P.3d __, 2008 WL 2051892 at *34 (emphasis added).

350. *Id.* at *45 (emphasis added).

351. *Id.* at *57.

352. *Id.* at *8, 27, 28, 32, 55 n. 71 (citing *Perez v. Sharp*, 32 Cal. 2d 711 (Cal. 1948)). The court noted that the *Perez* opinion emphasized the importance of an individual's freedom "to join in a marriage *with the person of one's choice*." *Id.* at *27 (quoting *Perez*, 32 Cal. 2d at 715 (emphasis added)).

353. *Perez v. Sharp*, 32 Cal. 2d 711 (Cal. 1948) (named in other opinions as *Perez v. Lippold*, 198 P.2d 17 (Cal. 1948)).

354. *Perez*, 32 Cal. 2d at 731–32.

355. *Marriage Cases*, __ P.3d __, 2008 WL 2051892 at *55 n. 71; *Loving v. Va.*, 388 U.S. 1, 12 (1967).

356. *Id.* at *61 (Baxter, J., dissenting).

357. *Id.* at *62 n. 4.

divided (four-to-three) vote” and that the same issue is now before the Connecticut Supreme Court.³⁵⁸

The California Supreme Court’s decision in the *Marriage Cases* seems to reflect an acknowledgment of the prevalence of same-sex unions. The Court noted that many persons and couples prefer to “live their lives without the formal, officially recognized and sanctioned, long-term legal commitment to another person signified by marriage.”³⁵⁹ The Court also commented that the 2000 Census reflected that at that time “same-sex couples in California were raising more than 70,000 children.”³⁶⁰ One newspaper reported that according to the California secretary of state, the November 4 ballot will include an initiative to define marriage as “a union ‘between a man and a woman.’” If passed, the initiative would overturn the California Supreme Court’s *In re Marriage Cases* holding that legalized same-sex marriage in the state.³⁶¹

The California opinion will certainly not settle the issue in this hotly disputed area of the law. However, historically the California Court has been at the cutting edge of new developments, and its decisions often presage positions taken by other courts much later.³⁶² The heavily detailed analysis of precedents contained in this opinion will also make it hard to ignore.

VII. PREMARITAL AGREEMENTS

The character of property that has been designated separate property under a prenuptial agreement is ordinarily honored if the circumstances under which the agreement was made satisfy the governing statute. The Uniform Premarital Agreement Act has been adopted in both Montana and California, as well as in twenty-four other states, with small variations from state to state.³⁶³ The Act’s enforcement provisions require that the premarital agreement be executed voluntarily, that it not be unconscionable, and that each party provide to the other a fair and rea-

358. *Id.* at *6 n. 3 (majority).

359. *Id.* at *31.

360. *Id.* at *38 n. 50.

361. Cathy Lynn Grossman, *Most Say Gay Marriage Private Choice; California Initiative Puts Spotlight on Voters’ Attitudes*, USA Today 7D (June 4, 2008).

362. *Marriage Cases*, ___ P.3d ___, 2008 WL 2051892 at *55 (referring to the *Perez* and *Loving* opinions).

363. See The Montana Uniform Premarital Agreement Act, Mont. Code Ann. §§ 40-2-601 to -610 (2007); see also *Wilkes v. Wilkes*, 27 P.3d 433 (Mont. 2001) (interpreting the Uniform Premarital Agreement Act and Mont. Code Ann. § 72-2-224).

sonable disclosure of his or her property or financial obligations.³⁶⁴ Subsection 2 of this statute gives a court the power to decline enforcement of a provision that eliminates spousal support.³⁶⁵

In California, under long-standing custom, the parties to a premarital agreement may properly agree that each spouse's post-marriage earnings will continue to be the separate property of the earning party. But the California version of the Uniform Act provides, in substance, that a waiver of support is not enforceable if the party against whom the support waiver is sought to be enforced was not represented by independent counsel at the time of the agreement or if the support waiver provision is unconscionable.³⁶⁶ Some attorneys have suggested that a prenuptial agreement that is signed immediately before the wedding is suspected to have been coerced or the subject of duress. The current statute requires that the party against whom enforcement is sought must have had at least seven calendar days between the time the proposed agreement was first presented and the time the agreement was signed to retain independent legal counsel.³⁶⁷ The party must have also been advised to seek independent counsel.³⁶⁸ This agreement must not be executed under duress,³⁶⁹ it must not be unconscionable,³⁷⁰ and it must make a full disclosure of assets and liabilities.³⁷¹ It is therefore highly desirable to have any prenuptial agreement executed well in advance of a wedding, to have both parties' respective property disclosures and financial statements attached, and to be sure that both parties are represented by independent counsel.

VIII. CONCLUSION

The constitutional requirements discussed above and the Uniform Disposition of Community Property Rights at Death Act combine to create a trap for the unwary Montana practitioner. The effects are pervasive. They are not limited to family law proceedings, but also extend to estate planning, probate, the preparation

364. Mont. Code Ann. § 40-2-608.

365. *Id.*

366. Cal. Fam. Code Ann. § 1612(c) (West 2004 & Supp. 2008); *see also id.* at § 1615.

367. *Id.* at § 1615(c)(1).

368. *Id.* at § 1615(c).

369. *Id.* at § 1615(c)(4).

370. *Id.* at § 1615(a)(2).

371. *Id.* at § 1615(a)(2)(A).

of federal estate tax returns, and transactions in real and personal property whenever any of the funds or assets involved belong to a couple who formerly lived in a community property state. As long as any of the funds or property is traceable to a community property asset, that property is still community property, notwithstanding that record title is held in Montana in some other form, unless there has been a transmutation of the community property interest. A community property asset does not lose its community character merely because it is removed to and reinvested in a non-community property state.

When an asset is community property, then upon the passing of the first spouse, the entire property, including the half interest belonging to the survivor, gets a new "step-up" (or "step-down") in the cost basis, to its value at the date of death of the first spouse to die. Thus, *both halves* of the community asset escape the capital gains tax, which (assuming the requisite holding period) would otherwise apply on sale of the asset. If, for example, the property is traceable to real estate which was originally acquired in California twenty or thirty years earlier, and the existing property is the result of multiple I.R.C. § 1031 exchanges, any previously unrecognized gain may be very substantial. Thus, failure to appreciate that an asset is really still community property can result in the loss of a very sizeable income tax benefit.

The problem is complicated by the fact that: (1) California recognizes acquisitions by "registered domestic partners," including same-sex partners, to be community property; and (2) its highest court has just invalidated, in the *Marriage Cases*, the California statutes that limited marriage to a contract between a man and a woman. It is therefore suggested that when a Montana attorney is dealing with a couple who formerly resided in a community property state,³⁷² the attorney should take the following steps:

1. Determine from the clients what property they currently own that has its source in community property on which the appreciation gain has not yet been taxed. (If the predecessor property has been sold outright, the gain would of course have been currently taxed at the time of sale. But if the predecessor property was disposed of in one or more tax-deferred exchanges under I.R.C. § 1031, the income tax basis of the initially owned property will

372. Community property states include: California, Nevada, Arizona, New Mexico, Texas, Louisiana, Washington, Idaho, Wisconsin, and (electively) Alaska. Mennell & Boykoff, *supra* n. 9, at 1; Alaska Stat. § 34.77.030 (Lexis 2008).

have been carried forward to the currently owned replacement property, and no capital gains tax will have been incurred).

2. Determine from clients whether they wish to preserve the community property character of their present community-source property. In making this decision, clients should consider the potentially substantial income tax benefit to the survivor if the community property character is preserved, since both halves of a community property asset get a “stepped-up” (or “stepped-down”) income tax basis to its fair market value at the date of death of the first spouse to die (or at the alternate valuation date if the estate qualifies and an alternate valuation date is elected).

3. Determine what the community property provisions are in the particular community property state in which the clients were formerly domiciled. This is particularly important if the clients came from California or from some other community property state that adopted the transmutation rules,³⁷³ because those states restrict the manner in which community property can be changed to separate (individually owned) property.

4. Irrespective of whether the clients do or do not wish to preserve the community property character of a community-source asset, the attorney should immediately document the clients’ decision. It is much easier to do that while both are still living, getting along with each other, and mentally competent. The documentation should be in one of the following two categories:

a. If the clients wish to preserve the community character of the asset, the attorney should draft and have executed a Community Property Agreement. Such an Agreement simply recites the community property history of the asset and states the parties’ agreement that it will continue to be community property, notwithstanding that it has been retitled of record in some other form (e.g., tenancy in common) since one cannot take title in community property form in Montana. For example, the Agreement might state (after a recital of the history of the property) that all of the property listed in Section X shall continue to be community property under the laws of the named state in which the clients were formerly domiciled, the property listed in Section Y shall be the individual (i.e., separate) property of the husband, and the property listed in Section Z shall be the individual property of the wife. Of course, property owned by each before marriage or acquired after

373. See *supra* pt. IV.B.7.

marriage by gift or inheritance is normally the separate property of the acquiring spouse. The Internal Revenue Service has historically honored Community Property Agreements.

b. If the clients do *not* want to preserve the asset's community property character, that should also be documented, paying special attention to the transmutation rules that require the transmutation: (1) be in writing; (2) be signed by each spouse and preferably acknowledged before a notary; and (3) recite the specific intention of the party who is relinquishing a community property interest to change that interest into separate (i.e., individually owned) property.

5. Agreements of either kind should of course contain the legal description of any real property and should specifically describe any personal property involved, since the Uniform Disposition of Community Property on Death Act³⁷⁴ also covers a wide range of personal property.

In order to provide competent and professional representation in the areas addressed by this article, the Montana practitioner must ensure that his or her clients' community property is properly identified and preserved. The practitioner can accomplish this by understanding the effect of community-source property in Montana, explaining to clients the potential benefits or consequences of preserving the character of their community-source property, and taking the necessary steps, including but not limited to those described above, to protect the clients' best interests with regard to their community-source property.

374. Mont. Code Ann. § 72-9-101 to -120 (2007).

